LOCAL GOVERNMENT COMMITTEE

Tuesday 25 September 2001
(*Afternoon*)

Session 1

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LOCAL GOVERNMENT COMMITTEE
24th Meeting 2001, Session 1

CONVENER

*Trish Godman (West Renfrewshire) (Lab)

DEPUTY CONVENER

*Dr Sylvia Jackson (Stirling) (Lab)

COMMITTEE MEMBERS

*Mr Keith Harding (Mid Scotland and Fife) (Con)
*Mr Michael McMahon (Hamilton North and Bellshill) (Lab)
*Tricia Marwick (Mid Scotland and Fife) (SNP)
Iain Smith (North-East Fife) (LD)
*Ms Sandra White (Glasgow) (SNP)

*attended

WITNESSES

David Dorward (Chartered Institute of Public Finance and Accountancy)
Steve Freer (Chartered Institute of Public Finance and Accountancy)
Ronnie Hinds (Audit Scotland)
Tony Knights (Chartered Institute of Public Finance and Accountancy)

CLERK TO THE COMMITTEE

Eugene Windsor

SENIOR ASSISTANT CLERK

Irene Fleming

ASSISTANT CLERK

Craig Harper

LOCATION

The Hub

Scottish Parliament

Local Government Committee

Tuesday 25 September 2001

(*Afternoon*)

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

Local Government Finance Inquiry

The Convener (Trish Godman): Okay, comrades, it is two o'clock, so we can start. I welcome Rita Hale back to the committee after the recess. We return to our local government finance inquiry. Rita Hale has had a bit of a journey today, but I am sure that the next hour will be interesting and exciting.

I welcome members of the Chartered Institute of Public Finance and Accountancy: Steve Freer, who is the chief executive; Tony Knights, who is a member; and David Dorward, who is vice-chair of CIPFA in Scotland. David Dorward has given evidence to the committee in the past.

You all know the drill. Steve Freer may give his presentation. If any of the other witnesses wish to comment at the end, please do. After that, I will open up the discussion to the committee for questions.

Steve Freer (Chartered Institute of Public Finance and Accountancy): I thank the committee for inviting us and for undertaking its review of local government finance, which is important.

The convener has introduced my two colleagues. I will add to that introduction that Tony Knights is one of the members who have been leading our work on improving the system of capital finance in local government. He is therefore likely to be most prominent in answering any questions that the committee might have on that area. David Dorward is one of our leading directors of finance in Scotland.

I will make some introductory comments, which I will keep brief to maximise the opportunity for discussion. The committee has seen and, I hope, read the written evidence that we submitted. I will make one general point about where that submission is coming from and draw attention to two key points that we tried to convey.

We start from a passionate belief in strong, responsible and accountable local government. I am sure that the committee shares that belief. As a consequence of that belief, when we discuss local government finance, we are trying to develop a good system that will underpin strong, responsible and accountable local government. That is a constant reference point for us in such discussions.

The current system has many virtues and we should be careful not to be too critical of it. However, it is not a perfect system for supporting strong, responsible and, in particular, accountable local government. In a couple of key areas—and probably in others that will come out in discussion—there are fine balances to be struck but, in the current system, they are slightly misjudged and tend to militate against accountable local government. I will draw out one area on the revenue side of local government finance and one on the capital finance side.

We are concerned about the key revenue balance between central and local sources of finance. In round figures, the ratio is currently stacked at about 80:20 in favour of central sources. We think that the balance ought to be shifted in favour of local sources of finance. In our written evidence to the committee, we suggest how we think that could be achieved in a reasonably straightforward way. However, these things are never entirely without difficulty, as we are talking about relocalising the non-domestic rate.

As for capital, the key balance that we think is slightly misjudged is the level of central control over individual local authorities' borrowing. We think that the centre's focus is inappropriate because it is micro-control, whereas the centre should be content with macro-control. We made specific proposals in our written evidence about how that difficulty could be addressed. We suggested that we should move to a system of local decision making that is underpinned by a code of professional practice—a prudential framework, as it is called in the jargon. Since we submitted our evidence, we have begun to develop such a code of practice. At an appropriate point in the discussion, Tony Knights will be happy to speak about our progress in that area.

I will resist the temptation to continue to do all the talking, as we would prefer to have a discussion. However, we hope that those two key issues will feature in the discussion.

The Convener: Do either of the other witnesses want to say anything at this point? You would rather wait. Right.

I take it from what you said that, although it has been some time since you submitted your written evidence, your views remain the same.

Steve Freer: Yes.

The Convener: I have a brief question. You say bluntly in your written evidence that the balance between central and local tax is wrong. Have you a view on what would be a legitimate and fair balance?

Steve Freer: We have a view, but it is more intuitive than evidence-based. Our instincts are that we should be looking for at least a 50:50 balance—perhaps the balance should even be tilted in favour of local sources of funding rather than central sources.

The Convener: You do not think that that would have any intended or unintended implications for the Barnett formula.

Steve Freer: I think that I might have to pass that question on to David Dorward.

The Convener: You looked aghast.

David Dorward (Chartered Institute of Public Finance and Accountancy): Your question is whether the non-domestic rate raising element might have an unintended or an intended effect on the Barnett formula.

The Convener: Yes.

David Dorward: No. I do not think that it would.

The Convener: No? Good.

Mr Michael McMahon (Hamilton North and Bellshill) (Lab): You seem keen to talk about the prudential guidelines and how they will impact on the capital finance regime. Just to give Tony Knights a chance to speak, I might as well ask the question. How well developed is the work that you have done so far? Are you working to a deadline? When do you expect the work to be completed? Has work been done on any changes that might come about in the grant distribution system, which is aligned to what we are discussing?

Tony Knights (Chartered Institute of Public Finance and Accountancy): Those are wide-ranging questions. I will just paint a little bit of background. There is work in progress on the prudential guidelines and code. However, that is happening against a background of work that CIPFA has already developed and that has been adopted by local authorities—it is in force throughout local government as a code of practice for local authority capital accounting. A code of treasury management is also being used. Those two pieces of work underpin the current work, so we do not have to start from a clean sheet.

The code is a work in progress. We are confident that we will be able to issue a consultation document on proposals for the prudential code and guidelines in December. That illustrates the progress that has been made. A prudential code in England will probably not be implemented until 1 April 2004, because primary legislation to alter capital controls is necessary there. However, in Scotland the opportunity exists to implement a prudential code earlier, because the same detail of restrictive capital controls does not apply. If the Parliament wanted to—our body would recommend it—it could sensibly implement a code from, let us say, 2002. Those are the time scales that I envisage for drawing up, consulting about and implementing the code, should it be agreed.

Mr McMahon: If you put your document out for consultation in December, how long do you think it will take to complete a valid consultation process that could be presented to the Scottish Executive to justify changes as early as 2002? Would it not be more seemly to wait for another financial year to kick in?

Tony Knights: I was not trying to rush the Parliament; I was just saying what the earliest opportunity would be. Obviously, any consultation would have to be of sufficient length to ensure that the views of all interested parties were fully taken on board. We intend to hold a lengthy consultation. I do not know what the specific time scale will be, but it would be sufficient to take on board fully all comments from interested parties. We believe that it is important to get the code right. I do not want to give the impression that we are rushing along with it. The priority is to ensure that we get it right, because such opportunities for change do not often come along.

Steve Freer: I want to add a couple of comments. First, it is becoming increasingly clear that 1 April 2004 is the earliest go-live date in England. However, our key point is that that timetable is not necessarily appropriate in Scotland. One issue that needs to be examined is the extent to which any changes require changes to primary legislation. The back-cloth in Scotland is different and our judgment is that, if anything, it might be easier to make such changes here than it would be south of the border.

Secondly, we are developing a professional code. One of the approval processes that we need to go through is that of the professional body concerned, which is CIPFA. It will be important to have a thorough and effective consultation process, to talk to important stakeholders, such as the Executive, and to satisfy ourselves that the Parliament is happy that what we propose will work. We will then go back into the formal decision-making processes—CIPFA's governance arrangements—to frank the code. In practice, that means that 1 April 2003 would probably be the earliest implementation date.

I return to Tony Knights's point. It would not be in anyone's interest to gallop this through and then repent at leisure. We need to get it right first time.

14:15

Mr Keith Harding (Mid Scotland and Fife) (Con): What changes would the institute like to be made to local domestic sector taxation in the short to medium term?

Steve Freer: In the short to medium term, we are interested in looking at council tax bands, particularly the number of bands and the relationship between them. We would like to make that taxation system more progressive. The other critical factor in keeping the council tax system fresh, as it were, is regular revaluation. We would like clearer arrangements for the regular revaluation of properties in relation to the banding system.

Mr Harding: Would you undertake a review of the banding system so that you could increase the tax take or so that you could redistribute the burden?

Steve Freer: Our principal motivation for suggesting a review of banding is to make the system fairer and more progressive. That would help to deal with the inequity that results from the fact that a great range of properties, from medium values to astronomical ones, are all in the top band. At the other end of the valuation scale, we could also make the system fairer for lower-value properties.

Mr Harding: Under a revaluation scheme, what should happen to people who have improved their properties? Under the existing system, they are not penalised and their tax does not change. Would they be caught in such a revaluation exercise? Would the revaluation be based on the former value, not including the value of repairs and replacements?

Steve Freer: To be frank, my instinct would be to value the property as it is at a specific point in time. I recognise that one could argue that that becomes a disincentive to improving property, but it is probably not such a significant disincentive that it would dissuade people from properly maintaining and improving their homes.

Mr Harding: I should probably have declared an interest, as I have just doubled the size of my property.

Does CIPFA see any merit in the introduction of a second local tax on the domestic sector?

Steve Freer: Our view is that, if the non-domestic rate were relocalised, there would be no case for a second tax on the domestic sector. There could be difficulties with that, but it is perhaps more a matter for the judgment of politicians than for the judgment of professional bodies. Nevertheless, there could be serious difficulties with the creation and introduction of a major new tax on the domestic sector. I emphasise the word “major”, to distinguish such a tax from the taxes at the margin that are sometimes suggested.

Mr Harding: Your report makes no reference to local sales taxes, land value taxes or any forms of local taxation other than council tax or possibly local income tax. Did you not consider other taxes or did you come to the conclusion that they were unworkable?

Steve Freer: It is certainly not a case of other taxes being unworkable. If I remember correctly, the point that we made in our written submission is that, if the Parliament were to consider what we call radical options—local income tax, land value tax or local sales tax—our strong advice would be to conduct careful research and rigorous testing of all the practical implications. In short, let us ensure that we do not have a rerun of the community charge experience.

The specific reason why we have not launched into arguments for or against a local sales tax or other radical options is that we are trying to be politically realistic about what is likely to be on the agenda in the medium and even the long term. However, if at some stage the Executive or the Parliament said that it wanted an issue to be considered and that it would be interested in a radical change of local taxation, we would be keen to play a part in examining some of the options to which you referred.

Mr Harding: I do not favour such taxes, but we have a wide remit and are considering all issues. We require evidence to discount issues as well as to prove them.

David Dorward: To follow on from what Steve Freer said, the institute has taken the line that the return of non-domestic rates to local government control would give local authorities control of 50 per cent of their revenues, so there would be no requirement to look for supplementary local taxation. We must also consider the effect that the introduction of a new tax—the sales tax—would have on the local economy. If individual authorities levied different sales taxes, there could be a detrimental effect on the local economy. The introduction of a new tax carries a heavy administrative burden. However, returning non-domestic rates to local authorities would not increase administration in those councils.

Tricia Marwick (Mid Scotland and Fife) (SNP): You say in your submission that general grants should be the norm and specific grants should be used only on an exceptional and strictly time-limited basis. Is the increase in the number of specific grants leading to difficulties in local government? Is local government’s autonomy threatened by the increased reliance on specific grants?

David Dorward: I would probably widen out the issue to cover more than specific grants. In the most recent statistics that I have seen, 30 per cent of the funding that comes to local authorities is either ring-fenced or hypothecated. That has two effects. First, it may force councils to provide services in a way that, on the ground, is not the most productive and does not represent the best value to that council. There are examples, such as the excellence fund, where councils—I speak here as a council officer rather than as a member of CIPFA—are forced to carry out policies that teachers and directors of education say do not offer the best value to the council.

Secondly, local authorities are hit with so many specific grants and initiatives that they do not have time to respond adequately. We have such an overload of initiatives and specific grants that the system may be becoming counterproductive. One of the main problems with a specific grant is that it is usually time-limited, which means that, after a period, it will be removed—the period could be a year or three years. After that period, we always face the problem of trying to accommodate, using mainstream funding, the service that we had previously provided with the specific grant. One could argue that authorities should be planning exit strategies. However, I find that those strategies are difficult to plan, particularly when we are dealing with the voluntary sector or needy projects that cannot be mainstreamed because of the general lack of funding within local government.

Tricia Marwick: Do you share my belief that the increased reliance on those grants, whether hypothecated or ring-fenced, is a threat to the autonomy of local government?

Steve Freer: To have resources passed over in specific penny packets with the requirement that they are spent in particular ways certainly does not strengthen the autonomy or local accountability of local authorities. It is positively unhelpful in relation to those principles about which I spoke earlier—healthy, strong, responsible and accountable local government.

In our written submission, we argue for the establishment of a clear statement or framework that spells out the criteria that would apply to a situation in which we would use specific grants as the appropriate method of funding. We have suggested what those criteria should be. To implement that proposal, central and local partners should have an input.

We are trying to arrive at a clear statement on the rules on specific grants and the circumstances in which they are the right method of funding. Practice should then be monitored to ensure that situations in which specific grants are used conform to that framework. That would create clarity and transparency about the use of specific grants, which is sadly lacking at the moment.

The Convener: On the same theme, the Chancellor of the Exchequer has in the past two years given money directly to schools. Do you think that that money should have come through the Scottish Executive or gone to the local authority? Local authority education directors do not like what has happened; they prefer to get the money and to make their own decisions about it. When I have visited schools that have been given money, I have found that there is certainly autonomy in those schools, which have been allowed to use the money as they see fit. How do you feel about that situation?

Steve Freer: We think that that money should be routed through the established funding systems, from the local education authority to the schools, rather than looped around via a separate arrangement.

The Convener: Does Mr Dorward agree?

David Dorward: I do. My mind is drawn to situations of school boards and devolved school management. Some schools carry large balances—they are affluent and can generate funds that they can then spend on school buildings. By allocating funds evenly throughout schools, we do not, I believe, target resources where there is greatest need.

The Convener: That is interesting.

Ms Sandra White (Glasgow) (SNP): I will follow up on grants. Before the Executive introduces a new scheme for councils to implement, should the scheme be appraised? In layman's terms, when the Government introduces a new initiative and the money is available only for a year for a specific task, if the scheme is implemented by local government and it is running well, local government should be able to fund it or be funded to run it for a further three years. Although the initiative might work well for a year, voluntary organisations—for example, after-school clubs—say that local government will not then give them the money for it. Do you think that such schemes should be appraised before they are introduced to local government?

14:30

Steve Freer: The strongest initiatives are those that are developed by central and local government working closely together in partnership. There are huge dangers when an initiative is not developed in that way and one party—in Ms White's example it is central Government—simply states what it is going to do and puts resources behind an initiative. First, there is the danger that the local authority will not understand all the thinking that is behind the initiative because it has not been involved in the discussion. Secondly, the local authority may intend to carry out the initiative only for as long as money is provided. In that case, two or three years down the line, when the money has run out or the idea is less fashionable, whatever good work has been achieved through that initiative will come to an end when the funding is withdrawn. That is not a sensible way of progressing.

The key issue with new initiatives is mainstreaming—making sure that successful new initiatives are taken into main programmes. The approach that Ms White outlined is potentially deficient on that front.

David Dorward: It would have been helpful on a number of initiatives if there had been consultation in advance to identify where the problem areas were going to be. I believe that with specific grants a review at the end of the grant period is also required because all too often projects fold. They may be good and successful projects, but they fold because of lack of finance. If those projects were reviewed and brought back to the Executive's attention, it might take a different view on the cessation of funding for them.

Mr Harding: I will pursue that point. We could remove many difficulties—and head teachers would receive more praise—if schools were funded directly, not through local authorities. Similarly, difficulties would be removed if health-related social services were controlled by health boards. Those measures would alter the tax-raising balance to 50:50 without changes being necessary.

Steve Freer: Well—

The Convener: You are not obliged to answer.

Steve Freer: Mr Harding's suggestion brings us back to the judgments that are implicit in these matters. Judgments must be made about which services it is appropriate to administer from the centre and which it is appropriate to administer locally because they are underpinned by strong local democracy. My view—I suspect that it is Mr Harding's view, too, and that he is playing devil's advocate—is that education is one of the services that needs that local democratic underpinning to be successful.

Mr Harding: I did not suggest that the services should be run by the Executive, but that schools should be run by school boards and that the health service should be run by health boards. The services would still be controlled and run locally.

Steve Freer: That shines a light on the role of the local education authority. Some activities need support that has the local democratic underpinning to which I referred; that support is handled less effectively by school boards than by the slightly higher local authority level.

The Convener: I have been lenient to Mr Harding, so we will move on to Sylvia Jackson.

Dr Sylvia Jackson (Stirling) (Lab): If I had a better memory, I would remember the name of the person who, in giving evidence, talked strongly about partnership between central and local government and set out some procedures for that. That person was going to come back to the committee with some work to emphasise the point.

I have a question about the relocalisation of non-domestic rates. Paragraph 4.5 of your submission mentions three issues that have to be taken on board. Have you worked on those, as you did with prudential guidelines? If so, will you share your findings with us? If you have not worked on those areas, are you willing to examine them for us?

Steve Freer: To be frank, it is more the latter case than the former. We are happy to work with you in future on the three key issues that we identify in paragraph 4.5 as requiring to be addressed, because we have not undertaken significant work on them. The first is

"the relationship between the council tax and the non domestic rate".

We must avoid the situation where a local authority says, "I have a good idea. Let's whack all the increase on the non-domestic rates. Businesses don't have a vote at local elections. Let's protect the council tax." It is important to cover that ground. That situation could be prevented by a formulaic link between the two types of taxation.

The second obvious but important issue is the equalisation of resources. Not all local authorities are equal in terms of the strength of their tax base, so it is important to have a system of equalisation. That is not unfamiliar territory, because the business rate was local previously. That is not to say that it would be as simple as deciding to do what we did 15 or 20 years ago, but there are mechanisms to handle a system of equalisation and we would be happy to be involved in working through them.

The third bullet point, which in some ways is the most interesting, is about how we build the bond of accountability between local authorities and non-domestic taxpayers. Demonstrably, there are a variety of ways in which that could be tackled, many of which have been tried previously. Some were successful, but others were not. The sort of issues that must be considered are, for example, the business-vote approach. Referendums are another way of tackling some of the issues. Placing a duty on authorities to consult business rate payers is another approach. This is difficult territory, but it is critical, even if we do not relocalise the business rate, because it runs so closely with local authorities' responsibility for community leadership and increasing responsibility for economic development and so on. As the best local authorities recognise, the relationship between local authorities and their business communities is a key relationship. There must be good communications and authorities must listen to that constituency.

Dr Jackson: In paragraph 4.6, you say more about the relationship between council tax and non-domestic rates. Your submission says that

"council tax is based on capital values whereas the non domestic rate continues to be levied on rental values."

You say that that is an issue. Would you elaborate on that?

Steve Freer: We are drawing attention to the fact that the two systems have gone in fundamentally different directions, which raises questions about the revaluation methodology and the frequency of revaluation. However, as in the areas that I have just spoken about, in paragraphs 4.5 and 4.6, we are flagging up the difficulties, rather than advancing the solutions. We recognise that we have to work through those areas and find the right answers to difficult questions.

Ms White: You said that businesses and local government must work together and that the Barnett formula might be affected if the arrangements for financing local government were changed. What would you think if a local authority decided to or was able to keep 100 per cent of its business rates? How would the Barnett formula or the moneys that came to that council from the Scottish Executive be affected?

David Dorward: I am sorry—

Ms White: I was trying to be clever there, but obviously it did not work. I wrote to the Executive about Glasgow City Council, which gathers in only 50 per cent of its business rates. I asked what would happen if Glasgow City Council argued to the Executive that it should keep 100 per cent of its business rates. The answer that I received from the Executive was that the money that Glasgow City Council received would be apportionate. In other words, the Executive would take that amount away. How do you react to that?

David Dorward: My understanding is that the situation Ms White describes would have no effect on the Barnett formula. However, I stand to be corrected on that. It is true that, previously, when councils retained all their rates—domestic and non-domestic—there was a resources element in the grants system, which balanced out the fact that some authorities had greater rateable values than others. As Steve Freer said, if non-domestic rates were relocalised, there would need to be some form of resource equalisation. However, if authorities had control of non-domestic rates, to a limited degree they would have greater control over their income. The grant would be equalised to reflect the fact that some authorities have large rateable bases. It is not simply the large authorities that have such bases. Authorities such as Falkirk, which has the Grangemouth refinery, have large rateable values that are probably disproportionately high to the amount of grant that they receive. If non-domestic rates were returned to local government, that fact would need to be reflected in the grant distribution system.

On the relationship between council tax and non-domestic rates, I refer the committee to the work that we have done in Dundee City Council since 1996. The ratio between the amount of money raised in non-domestic rates and that raised in council tax was initially 60:40, but it is now 40:60. The council tax increases over the intervening six years have been large in comparison to the increases in the non-domestic rates. However, the services that the whole community has received have remained constant or have improved.

Ms White: Everyone knows that most people depend on local government for important local services. Over the years, the issue of improving local government finance and how local people contributed to it has been considered. There are many areas in which people have presented a case for change. What makes you think that your submission will be more successful where others have failed? Do you have a basic case to put apart from your submission? I am thinking in particular of the exclusion of local authority self-financed expenditure—LASFE—from Government spending controls. How would you present the key points to argue your case?

14:45

Steve Freer: First, I will repeat some of my earlier points. It is important in such debates to say a kind word or two about our current system. In such discussions, there is an extent to which we focus all the time on what is wrong with the current system and end up persuading ourselves that it is pretty hopeless. In fact, the current system is pretty good; it works well and is quite sophisticated. However, the big question is: is it the best that we can do?

We are very aware of the fact that, since the system was introduced, just about everything around it has changed. For example, the local tax that sat in the middle of the system when it was first designed and the structure of local government have changed. Furthermore, the creation of the Parliament means a new umbrella above the new system of local government. One of the positive aspects of our current system is that, as each of those changes has occurred, we have made adjustments and adaptations, many of which have undoubtedly worked very well.

However, there is a danger that some adjustments are serving us less well, which brings me back to the balance of funding. We have—almost accidentally—ended up in the position that a large proportion of local authority funding comes from the centre. Furthermore, some initial adjustments linked the system to universal capping. Although that kind of capping has been abolished, selective capping still sits in the background. How well does that serve accountable local government?

All those aspects lead us to conclude that it is about time that we stood back, examined the whole system and asked ourselves the big questions, such as whether there is a better way and whether the system can be improved. That is why we support the committee's work so much. Our objective is a system that underpins good, strong, healthy, responsible and accountable local government.

As for Sandra White's point about definitions, I do not think that that is a critical issue. The real acid test involves the adjective "accountable". We must create a system of local government finance that encourages the best sort of local government and leads to that other goal with which we are so concerned—democratic renewal.

Ms White: You did not tell us your views on the removal of LASFE from central Government control.

Steve Freer: To be honest, we are ambivalent about whether there is a case for the removal of local authority expenditure from the system of national controls. However, that is not the key issue. The key issue is achieving accountability in the relationship between the local authority and the community that it serves.

Mr McMahon: Keith Harding was trying to take us into a controversial area with his earlier question on education; my next question on public-private partnerships and the private finance initiative might generate controversy. What is CIPFA's view on the value for money of the PPPs and PFI programmes that have been developed in Scotland? What sort of guidance would be used to assess or appraise PPPs?

Tony Knights: PFI and PPP schemes are individual schemes for individual local authorities. Their value for money or worth must be assessed by examining individual cases. In that respect, CIPFA does not have a general view about whether the schemes represent value for money.

I refer to our work on capital and prudential guidelines. Over and above the current borrowing limits that are imposed, PPP is the only game in town, especially for larger schemes. It is inevitable and proper that local authorities consider it as a realistic and valid option for investment in larger capital projects. It is the only option available over and above restrictive borrowing controls.

Under the prudential guidelines, we envisage other options. We could validly test the PFI or PPP scheme against more traditional ways of delivering capital investments or services associated with capital investments. That would allow comparisons to be made.

CIPFA has issued guidance on issues that local authorities should look at. It is a job for the Treasury as well as the council to ensure that such matters are examined. I mentioned comparisons with other forms of achieving the same investment. How much one scheme would cost in relation to other schemes is a simple comparator. Other best-value tests can be applied to PFI, which the local authority can undertake to see whether it wants to pursue a particular PFI scheme. Certain caveats apply to such tests. It would be a useful exercise if the Accounts Commission for Scotland or Audit Scotland carried out a retrospective assessment of PFI schemes.

Mr McMahon: I was about to ask about that. Tony Knights said that CIPFA does not have a general view on the general merits or demerits of PFI. Angus MacKay held a similar view when he sat in the same chair that you are now sitting in. He said that all the schemes are individual and should be examined on their own merits. Given Tony Knights's view, I suppose that that is a consistent line to take. Should someone who is external to such matters decide whether certain PFI and PPP schemes are successful and the best value for money? Is that the only way in which they can be assessed?

Tony Knights suggested considering alternative ways in which to involve private finance. Others have referred to public service trusts. Does he make comparisons between such theories and the practice of PPPs and PFIs?

Tony Knights: I agree that it is incumbent on local authorities to examine other options and assess their costs. CIPFA cannot do that other than in general terms, although it has issued guidance on such matters. I agree that it is the proper role for individual local authorities to take such action, as it is for the Accounts Commission and other audit bodies.

Tricia Marwick: To continue on the PPP and PFI theme, Tony Knights said that PPP should be seen as one of a range of finance and procurement methods available to public service managers, but he then confirmed that PPP was the only game in town. What other methods would you like local authorities to consider? Do you believe that local authorities are being prevented from considering other options?

Tony Knights: When I spoke about PPP being the only game in town, I was referring specifically to larger schemes. I recognise that local authorities have limited borrowing capabilities for capital investment. However, I want to say something about the guidelines for the prudential code, as they create a genuine option. We envisage a code based on affordability. The sum specified would not necessarily be the limit up to which local authorities can spend money. Rather, it would be the upper limit beyond which they should not spend money on capital investment. That would create some flexibility for borrowing capital finance for a large capital scheme, should such a need exist.

Coupled with that is the guideline that states that capital expenditure should be planned over a period of three years or more; that revenue effects should be taken fully into account; that local authorities should develop asset management plans to underpin the process; and that those plans should be available to local government. That brings me back to the word that I used before—partnership. Under the scheme that I have described, it would be clear from the plans that capital investment was being properly planned and aimed where it was needed. That would create the opportunity to have an alternative funding mechanism to a PFI scheme. It would also create a valid measure.

Traditionally, capital financing of local authority investment projects has been done by borrowing money from central Government, which is the cheapest borrowing that is available to any organisation, whether local government or commercial. It is certainly a very cost-effective option. The framework that we propose would create more opportunity for considering other means of capital investment. Having more freedom to invest capital would not prevent authorities from having more freedom to work in partnership. Local authorities would have more opportunity to work in partnership, where appropriate, with the private sector in the provision of capital investment and the services associated with that.

Tricia Marwick: Ultimately, however, it would be for central Government to approve capital consents, and that would limit the local authorities' ability to borrow to fund capital projects.

Tony Knights: I would not go so far as to talk about capital consents. Local authorities are now required to submit three-year asset management and capital investment plans. That allows Government to assess how those plans impact on the totality of capital investment and of borrowing, so that they can be taken account of in overall economic planning.

We understand the constraints within which both central Government and local authorities work. For that reason, we suggest a twofold approach. Ultimately, there would be a limit of affordability. That is what we are trying to get across, and we believe that our point is understood. We need to consider what a council can afford, based on its long-term revenue plans. Capital investment costs revenue: if people borrow money, they must pay it back. Local authorities need to assess the affordability of their capital plans. At national level, the Government needs to assess the affordability of the totality of capital expenditure plans. The provision of a prudential guideline will give them the opportunity to do that in advance of capital monies being spent.

Dr Jackson: In paragraph 5.14 of your submission, you discuss the grant distribution system and how it might be improved. Can you expand on the three bullet points in your submission? Do you know of any work that is being undertaken or that may be undertaken in the future?

15:00

Steve Freer: The bullet points represent three classic areas that need to be kept under constant review in the type of system that we currently operate. We should always be scanning to ensure that we are using the most appropriate statistical techniques. We should be wary that what was selected as the right statistical approach five or 10 years ago may no longer be serving us as well as it did previously. A classic example of that is the use of regression analysis within the system.

I certainly do not have complete knowledge of all the work that is being done here, but I am aware that, at different times, different organisations have advanced arguments for the use of other techniques. Those arguments need to be considered carefully.

Changes in data are another source of difficulty. One is tempted to say—one does say—that we should always use the very latest data, but we must be mindful that introducing data changes, particularly with turbulent data, can create difficulties in the system. We cherish stability in grant distribution systems and sometimes data can be quite disruptive to stability. That is another key area to work on.

In some ways, plausibility checks are also increasingly important, and that touches on another key area of difficulty for us. Once a system has been introduced, there is almost an inexorable temptation to keep finessing it and, in the process, making it more complicated and completely unintelligible—other than to the adviser to the Local Government Committee. Having a system that people understand is an important component of the discussion about accountable local government.

All those are key areas to come back to, but I stress the answer that I gave earlier. Our view is that we should not swoop into the minutiae of the system, which the three bullet points represent. Let us first of all take this welcome opportunity to stand back and look at the whole system. The system has developed incrementally over a long period, during which there has been a fantastic amount of change in the structure and organisation of government in Scotland. Let us have that high-level review before we swoop into the minutiae of the current system.

Dr Jackson: You talked about the bigger picture. Should we be considering any other aspects of the public sector borrowing requirements that you have not mentioned?

Steve Freer: There are a number of areas in which we think that work ought to be done. Most of them are in play, but I will enumerate them.

First, there are some important changes in relation to the current council tax system, for example consideration of banding and valuation, and getting that properly underpinned.

Secondly, there are some changes that relate more to expenditure and grants. Many members of the committee may think that capping has been abolished, but it has not. We have simply reverted to a system of selective capping. That is still an important issue, because the control is potentially inappropriate. The council tax benefit subsidy limitation scheme, which was introduced a few years ago, is closely linked to that issue. If council tax is set above a particular threshold, the subsidy starts to cut off. Perhaps I am being unkind, but that seems to be capping by another name. We should question whether that approach and the level of control are appropriate.

Thirdly, as we mentioned, there has been a disturbing drift towards specific grants and other styles of hypothecation, and away from general grants. That seems to be a move in the wrong direction.

Finally—this also links to comments that have been made earlier—we should never get too locked on to the revenue side. That is inevitably the most pressing problem, particularly for local councillors. There are important changes in relation to capital. Professional codes of practice and prudential frameworks, for example, tend to sound terribly technical and, in some ways, they are. However, we think that those changes would make an enormous contribution to accountable local government.

The list is not complete, but it attempts to pull together levels and areas where we think urgent work ought to be done.

David Dorward: I want to add a Scottish perspective to the point about grant-aided expenditure. People forget what the purpose of the GAE system is. The amount of detail in the system and the effort that goes into it are beyond belief. The system has developed over 20 years and, because of its history and the industry that it created in the Scottish Office and has created in the Scottish Executive and councils, a myth has grown up that it cannot be touched. The system is far too complex—only a handful of people understand it, and it is not responsive to changes in spend or need within local government. It is therefore a bit like an oil tanker—we will never turn it around. We will never get it to reflect current levels of need.

GAE has been used by the Executive to distribute funding erroneously in some cases. The system has been developed statistically over a long time and carries great credence that it is somehow a representation of need within individual authorities. The allocation of funding in respect of the McCrone settlement is a prime example of the system allocating funding not in line with need, but in line with perceived need—the number of pupils.

Debates on issues such as rural and urban deprivation have shown that it is difficult to reflect expenditure needs that are caused by deprivation. We are talking about addressing not the causes of deprivation, but the effects. Council expenditure is greater in authorities that have higher levels of rural and urban deprivation. The GAE system fails to reflect that adequately and has been used inappropriately in those two areas. The system should be simplified. We should move to a system with fewer indicators, which would be more intelligible to people and understandable on a year-on-year basis. CIPFA has a role to play in that. I go back to the point that was made earlier: we carry a degree of objectivity that other bodies may not have.

Tricia Marwick: Some local authorities seem to rely on revenue, especially on housing revenue account, to pay for capital projects. Do you have a view on revenue funding of capital expenditure?

Tony Knights: It is a legitimate way to finance capital expenditure and an alternative to borrowing. The issue for local authorities is whether one can afford to finance long-term capital investment from one-off revenue contributions, or contributions from the revenue account, since the total amount falls immediately on council tax. It might not be easily affordable, in the context of other points that we have discussed this afternoon. It is—and ought to be—a genuine option for capital financing, but it is not always a practical proposition owing to the restraints that we have discussed in the authorities' revenue budgets.

It is for a local authority to decide what level of affordability there is in housing revenue accounts and therefore whether capital investment can be met directly from revenue. I suspect that local authorities will be in different positions on that. Revenue funding of capital is a legitimate option for local authorities, although there are restraints and restrictions on whether a local authority could easily access it.

The Convener: There are no further questions, but I will make a couple of comments on what we have heard.

The committee has undertaken research on council tax banding—a team from Heriot-Watt University is examining the matter on our behalf. That research arose from our review of local government finance. We had the idea long before Westminster did, but we did not publicly do anything about it. We are not following on Westminster's coat tails; we had done it already.

I take the point that was made in response to the question that Keith Harding asked about other taxes. The matter must be considered in greater depth, especially the administration of other taxes. I also noted the comments about selective capping.

David Dorward said that GAE seems to be something that "cannot be touched". I assure him that the committee does not believe in such phrases: if we need to touch it, we will. I agree that GAE probably needs to be simplified. That will be considered in our review of local government finance.

We have been saying that we need to stand back from local government finance, consider the whole system and see where improvements can be made, because we want good, strong, accountable local government that provides services. That is what we are saying and that is what you are saying. This has been a productive hour and 15 minutes. I thank you very much for coming and if we need to see you again, we shall call upon you.

For the next part of our examination of local government finance, we have witnesses from Audit Scotland. Ronnie Hinds, who is the controller of audit and deputy Auditor General, was before the committee in April. Gillian Gibb is the technical adviser.

As you have been here before, you know the drill. I invite you to speak for a few minutes and then I will open the discussion to the committee for questions.

15:15

Ronnie Hinds (Audit Scotland): This is the first time that I have been before the committee in public. I gave evidence in a private session in April on the Accounts Commission for Scotland's local government overview report. I am happy to be back in a public meeting.

The subject of the inquiry is one in which, as the committee can see from our response, we have an interest. I would not say that audit was absolutely central to local government finance. The reason for that is primarily that, quite properly, the committee is closely examining areas of policy. As auditors, we have no official view on areas of policy, so our response does not touch on every part of what the committee is considering.

That said, we have commented on four topics that are within the remit of the committee's inquiry and I will give a brief update on our position on those.

We have made the point that we have a continuing interest in council tax. The Accounts Commission has done a major study on council tax collection in the past three to four years and, as members of the committee will know, we publish annual performance indicators, which include performance on the collection of council tax. Because we try not to be distant from what happens in the real world, we maintain a role in working parties of one sort or another. There is—or has been—a working party on council tax. Gillian Gibb and her colleagues have been involved in that to some extent.

On the grants system, our role is not a statutory responsibility, but we are invited to audit certain grant claims—some specific and some more general grants. In our submission, I make the point that a significant amount of local government finance—perhaps an increasing amount—is doled out by means of specific grants. The evidence that you have just heard supports that. The process of auditing such grants becomes a bigger issue.

The current position is that over 25 per cent of the specific grants that are available are not subject to external audit, which obviously means that nearly 75 per cent are subject to external audit. That raises questions about consistency. My view is that auditing specific grants—or anything else, for that matter—is primarily a means of giving public assurance on whatever objective or expenditure is involved in the process. I cannot think of a good reason why external audit should be required of some specific grants but not others. There can be cases in which external audit is simply not worth doing because the amount of money that is involved is not great. That is not the pattern that we have witnessed so far in our role in auditing grants.

We also touched on the prospective migration towards a system of what are now called local outcome agreements or public service agreements. That is the developing dialogue between central and local government to get away from hypothecation. Particularly in that area, we wish a consistent approach to be taken to the role that audit might play. Not only is there the issue of assurance, but there are performance-related issues in relation to local outcome agreements. By that, I mean that such agreements are or should be about delivering specified outputs and outcomes for the money that is awarded. In that context, it seems to be appropriate that there is some independent verification as well as assurances that those outcomes are being properly achieved.

The third area that we touched on was capital finance. As an aside, I have been personally involved in the discussions on the introduction of a prudential system of guidance that the previous set of witnesses talked about. I found that work to be interesting and stimulating, although it gets a little technical at times.

As an auditor, I offer the view that when the prudential code is produced, a significant part of it—although perhaps not the most important part—will be the design and use of indicators. Those indicators will be ratios of one type or another. There will be measures of indebtedness and, indeed, of the affordability of debt. An important part of the overall objective of introducing a prudential code in place of statutory controls is that there should be an independent view as to whether those indicators are being properly used or measured against.

Finally, Audit Scotland is doing some work on PPP—I will use the abbreviation PFI because I have difficulty with the triple P's—and a study is under way that will report early in the new year. The study will consider PFI and, in particular, the value-for-money aspect of PFI. I understand that the committee has a line of questioning on that issue as well as on other areas. I will say no more in case I tread on that ground, but I will be more than happy to answer questions about the nature of the inquiry that we are conducting into PFI.

The Convener: Briefly, what do you think are the strengths and weaknesses of the present local government finance system? What causes you greatest concern?

Ronnie Hinds: Right from the beginning, I am in a little difficulty. Without venturing into areas of policy, perhaps, it would be difficult to make an assessment of strengths and weaknesses in that broad context—that is, if we are considering the local government finance system. Because we report regularly on local government finance, you will know that there are aspects of it—in the narrower sense of accounts—that we have some concerns about and some points that we see fit to raise. I will enumerate one or two of those cases and refer to the overview report that we produced for the 1999-2000 audit.

In some councils, we identify occasional weaknesses in basic accounting controls. That was perhaps the most important point that was made in the last overview report, and it remains a matter of concern, particularly now that it has been five or six years since local government reorganisation. Understandably, reorganisation created some difficulty and turbulence in the system. Nevertheless, we think that those weaknesses in accounting controls should not be there and, where they exist, they expose those councils to risk.

There is also an issue about the complexity of some arrangements within local government finance. As an example—no more than that—I cite benefits administration, which is notoriously complex and crops up annually in our audit work. My concern about benefits administration could be best expressed by saying that it is difficult to establish and maintain the stable systems and procedures that are needed to deal with large sums of money and with people who depend on those sums of money, as people on benefit tend to do. The rules are continually being chopped and changed and local government systems and procedures have to adapt on the hoof to respond to those changes. That explains some, but not all, of the weaknesses that we have identified in that and other areas where complexity is a factor.

Finally, in looking ahead—I do not express this as a concern—we welcome a potentially expanding role for local government as proposed in the forthcoming local government bill and in other proposed initiatives, like the power of community initiative. The committee would expect me to say, and I would say, that that expansion will have to be balanced with a reassessment of the levels of control that must prevail within local authorities. That is particularly true if local authorities are to take a lead role in co-ordinating work between themselves and other public bodies. That leadership carries with it an additional responsibility to be seen to be whiter than white and to have good standards of governance and stewardship. When the bill is introduced, we will be looking with interest at the issues that it may raise for us as auditors for local government.

Mr McMahon: Your submission does not make much reference to grant-aided expenditure or aggregate external finance systems. Would you like to take the opportunity to refer to them now, specifically with reference to any difficulties with such systems? Previous evidence has highlighted some difficulties, and our experience of local government shows that there are concerns about the restrictions that are placed on local authorities by the setting of GAE.

Ronnie Hinds: Our reason for saying nothing about GAE is related to my earlier comments on policy. You will have detected from previous witnesses' contributions that it is difficult to disentangle questions of the distribution of moneys from questions of policy. There are statistical formulae, and judgments, sometimes of a managerial nature, can be made to determine those issues. Ultimately, however, those questions rest on political ground. Even before we get to the stage in the GAE distribution system of examining populations and other demographic and statistical analyses for distributing the money, a political judgment will have been made about how much money is available to start with. Such judgments govern how much goes into the local government pot as opposed to the health pot or into other areas of the Scottish Executive's overall responsibility.

It is therefore impossible to disentangle the GAE system per se from wider questions of policy. Those are not appropriate or fertile grounds for audit review. I have made no submission on that subject, and I find it difficult to envisage there being audit activity in those areas in future.

Mr McMahon: Do you have any objective views on how the system could be improved?

Ronnie Hinds: I have personal views, but I had better keep them personal. From a professional point of view, I can endorse to some extent what has already been said. Accountability is not well served by having arrangements that are so complex, and occasionally so arcane, that only a few can actually understand them. I support the moves that have been made in Scotland in the past couple of years to simplify the system, but that is a methodological matter and is therefore reasonably safe ground for me to comment on. Anything beyond that, and anything of a policy nature, is entirely a matter between the Executive and local government.

Mr McMahon: Very diplomatic.

The Convener: I have another question about grant distribution. Have you looked at any other developed countries that use that system? If you have, have you seen anything in those systems that you would like to be introduced in Scotland?

Ronnie Hinds: In point of fact, we have not looked at other countries. We would conduct research on such an area only if it was leading towards a study that we wanted to carry out or if it was necessary to support continuing audit work. Nevertheless, I was intrigued by your question. The technical section, of which Gillian Gibb is a member, is the area to which I would look to see whether there is any information that we could readily gather. I will probably do that, because I am interested to know whether there is any such information that is reasonably accessible to us and which would not take a great deal of time and effort to obtain. Research would not yield a very productive result for us, as it is not our area of responsibility.

The Convener: Have you ever spotted any features of the system that give local authorities perverse incentives?

Ronnie Hinds: Do you mean features of the finance system? I am talking now about something that has yet to happen, but when we come to local outcome agreements I am concerned to find assurance and give assurance that we are not perversely rewarding failure or penalising success. For example, an authority that is already doing a very good job in providing a service might be unable to secure much additional funding because it is already on a high plateau and the distribution mechanism for new funding will tend to take account of other aspects. That was touched on by the previous witnesses.

Issues of perversity could arise in local outcome agreements. It is a complex and potentially quite contentious area, so we would want to maintain a watching brief over it and be involved in the discussions about which agreements were set up, and which measures were used to assess their effectiveness.

Mr Harding: In your written evidence you mentioned the collection and administration of the council tax. Has Audit Scotland considered the size of the yield from the council tax? If so, do you have a view on the proportion of council spending that could be raised by the council tax without damaging the collection rate?

15:30

Ronnie Hinds: I hesitate to say again that that might be an area where policy would intrude—it is obvious that it is. One of the points that emerges from my review of council tax yields since reorganisation is that over about a four-year period, from 1996 onwards, there has been an increase in the average council tax of around 20 per cent. It has been considerably ahead of the rate of inflation.

Part of the reason for that, as has already been explained to you, is the interrelationship between council tax and other aspects of the local government finance system. While there has been an increase in the overall level of expenditure that has been permitted to local government, it has not been followed in commensurate terms with an increase in the central Government grant in one form or another. The burden has therefore fallen on the council tax.

Interestingly, if we consider the performance indicators and the rate of collection over that period, it has improved. The evidence there does not suggest that even quite substantial increases in the yield of the council tax necessarily result in a reduction in its collectibility. I would stress that that has not happened because of a step change, by virtue of a policy decision—let us say—to go out and collect twice as much in council tax as we do at present, but because of significant but incremental increases over a period; therefore it has been better managed in that sense.

Local authorities probably take quite a lot of credit for the fact that they have put in place a lot of good measures over that period to improve their performance. Whether that could be sustained through a major change, for example, to double the amount collected in council tax, is anybody's guess.

Ms White: We have already heard from CIPFA, which is particularly concerned about the specific grants. You mentioned that yourself. You seem to agree that you are concerned about checks and balances in specific grants. I understand that you do not want to comment on particular policies, but could you give us your views on particular approaches? Do you see any risks in the hybrid approach that is taking place at the moment, where some grants are audited and others are not? Should all grants over a certain level, whether or not they are specific, be given an independent audit?

Ronnie Hinds: My concern is to do with consistency of approach. There are substantial sums of money that pass, by way of grants, from central to local government that we would not call specific grants. Whether it is one sort or another, assurance is at the heart of it. I cannot see a particularly good reason—apart from practical considerations about materiality and it not being worth the audit effort—why that assurance should not be equally valuable for one grant and another.

The current system has not been designed so much as evolved over time. That comes down to consistency of approach, not only within the Scottish Executive—because it is largely grants from there that we are talking about—but over time. It is possible that the same part of the Executive might take a view about a grant now and a different view in future. That may happen simply because the purpose of having an audit carried out has not been thought through sufficiently. I am not fishing for work—far from it. However, I need to be persuaded that the current system, which is something of a curate's egg, is the best one. Consistency one way or the other would be better than what we have.

Ms White: Consistency and, I presume, accountability for the public purse.

I do not want you to name any specific examples—although if you do, I am sure that members will listen and take note—but do you know of any instances of bad practice that are currently giving you cause for concern? Are those isolated instances or are they more common than that?

Ronnie Hinds: I do not know of any instances of bad practice. When doing audit work we occasionally question grant claims. That is part and parcel of the reason for doing the work in the first place. We are there to give assurance. I highlight that simply as a means of demonstrating the importance of having independent assurance where public moneys are at stake.

Ms White: You mentioned the many changes that have taken place in public finance, some, though not all, of which you audit. What changes would Audit Scotland consider appropriate under the existing finance regimes? What are your proposals for the verification of local public service agreements or the equivalent of those?

Ronnie Hinds: I can give one response to those two questions. The changes that we would welcome are those that would move us towards a more output-based or outcome-based assessment of the effectiveness of public expenditure, whether it be through specific grants or through other financing mechanisms.

That brings us on to the question of how to verify public service agreements or local outcome agreements. We do not have any specific proposals on that, because thinking about the issue is still at a formative stage, as I am sure members are aware. Pilot agreements are running in seven local authorities. Those are restricted to particular areas of service, of which educational attainment is probably the most significant. Like others, we are interested in seeing the outcome of those pilots. That will enable us to determine whether a major move is taking place away from a grant system that, particularly as regards specific grants, is mainly related to inputs—paying for a certain number of people or computers—to one that is more closely related to service outcomes. Such a system would focus on how people perceive local government services and the things that are done for them.

Another issue is the relationship with best value. Best value is at least partly about being customer-focused or citizen-focused. The more that we are able to devise arrangements that measure outcomes with which the people who use the services can identify, the better. If assessment is seen to be related more closely to what people experience, that will remove some of the mystery that surrounds local government business generally and the way in which it is financed in particular.

There are some downsides to that. One issue that needs to be addressed is the number of plans that local authorities have to produce at the moment. I hope that, as we move towards having local outcome agreements, there will be an opportunity to rationalise those plans to a significant extent. The current arrangements are not only a burden on the council administration, but confusing as regards accountability. They are not the best way of using resources that could be diverted towards more front-line services.

Because of the work that it has done over the years on performance indicators, Audit Scotland has an expertise that it is happy to deploy in an advisory capacity. We have offered to assist the Executive as it designs measures for assessing outcomes and outputs. We would also be happy to assist in an assurance capacity, when the measures are being used to determine whether the service that was supposed to be funded has been delivered. It is fundamental that we have objective measures that people understand and that are independently checked.

Dr Jackson: I will turn to the question that you said we could ask, Mr Hinds, about the triple P's and about your inquiry to date. In the studies that you have already done—your routine council audits—what issues were raised? Were concerns voiced about PPPs, in particular?

Ronnie Hinds: I hope that I did not misrepresent myself by stipulating which questions could be asked and which could not—I was referring more to which ones I thought I could answer safely.

We are doing a major study on PFI and the most important point for the committee is that we are focusing on local government in the first instance. Because Audit Scotland has a purview that goes across the public sector, we could have chosen other areas in which PFI is used extensively, but we selected local government and schools in particular.

We did that for a number of reasons, the first of which was the sheer volume of expenditure that is now being incurred through the PFI in that quarter. The total sum that has been signed up or committed to date is, I think, about £2.7 billion. I know that the numbers tend to move around a bit—I am talking about the capital value of building an asset and what goes with that. Of that £2.7 billion, about £600 million, nearly a quarter, has been spent on schools alone. That makes schools a very big sector and therefore of some interest.

Another reason for examining the schools sector is that a large number of projects are involved. It is usual to have comparators in an audit study—a range of projects from which lessons may be drawn. Part of what we are doing is trying to draw lessons for the benefit of other authorities, in local Government and elsewhere, that may choose to go down the PFI route. It is nice to have a good spread and we have that in the schools area.

The last reason why we think that the schools sector is worth studying is that it is growing. In some other sectors, for example water—I was about to say that the situation was stagnant—there has not been an awful lot of PFI activity. The activity that was undertaken was started in the mid-1990s to address the problems then experienced with the water and sewerage infrastructure. Much of that work has now been completed. The contracts have been signed, the assets have been constructed and the service is being provided. Nothing much has happened over the past few years.

By contrast, in education and specifically in schools, it seems not only that substantial work has been done, but that there is a prospect of even more to come. We thought it important, if we were to examine work that was current and of interest, to pick an area in which PFI is developing. It seems that education, particularly schools, provides a case in point.

That is the scope of the study. Its angle is one of value for money. Various aspects of PFI merit study, but that of value for money seems to me to be primus inter pares. As members will know, that question is raised frequently by various people, and I am quite happy to say, even before the study is finished, that I do not think that there will be a yes-or-no answer. It will depend on what happens in each case. We hope that, by considering a sufficiently large number of projects of a similar type in one sector, we might be able to draw some useful general lessons. This is the first time that such a study has been done in local government in the UK.

Dr Jackson: What is the time scale for the study? What were some of the concerns that arose during your routine audits?

Ronnie Hinds: We hope to be able to report on the study early in the new calendar year, probably in February or March. Coincidentally, that is also the time scale for the Finance Committee inquiry that is now under way. I spoke to its members about our study a couple of weeks ago. That was a useful experience.

I will turn to the second question. Because very few PFI deals have been signed and completed in local government to date—the most advanced, by some margin, being the Falkirk schools deal—there is not much routine audit activity to comment on. It only becomes a matter of audit when there are transactions in the annual accounts. Those only appear once the assets are built, the contracts are signed off and the services are being provided. Falkirk Council is probably the only council where that has happened, and nothing has come to my attention regarding that.

At an earlier stage of all the current schools projects, we were asked by the local authorities to offer an opinion on the accounting treatment, which is another contentious PFI issue. We were able to give only limited assurance, because the question whether assets should be on or off the balance sheet—which tends to be the key accounting question—is one for the local authorities to determine. They will pay for advice, not just from the advisers on the project, but from the various players in the field who offer it. The best that we can do is to offer some testimony to the effect that the decision was reached through a proper route; we do not say whether we think it is on or off the balance sheet.

15:45

The Convener: After listening to people this afternoon describe PPPs and PFI programmes as the only game in town, I have a question on an issue that is perhaps not within your remit. Should we train councillors and officials to be able to make a more critical and detailed assessment of the immediate and long-term implications of PPP and PFI?

Ronnie Hinds: Yes. Touching on something that the witnesses from CIPFA mentioned earlier, I think that the Executive has a very important role to play initially in assessing the effectiveness of PFI deals that have been sanctioned so far. That is only good practice, particularly when—as in local government—the Executive is putting up something like 80 per cent of the on-going funding required to pay for these schemes over 25 or 30 years.

After putting up such funding, the Executive and local government should stand back from the exercise and ask how it went and what lessons can be learned. I imagine that one of the lessons that would emerge is the fact that there is a learning curve for everyone involved. I am sure that every local government officer who was involved with PFI—and I was one myself for a time—would immediately endorse that statement. Everyone finds it difficult. PFI is a minefield and the advice needed to find one's way through it comes at a price.

Specific issues relating to councillors have been raised by a number of authorities that have gone down the PFI route. For example, there is the difficulty of balancing the accountability of the council—and therefore of the councillors—for everything that the authority does, with the issue of commercial confidentiality. I do not profess to have an answer to that problem at the moment; it is an issue that we will consider in the course of our inquiry. However, in the interests of genuine accountability, I perceive a potential risk there, and part of the answer is to train councillors in the role that they should play when such a contract is negotiated and signed.

Ms White: Is there anything in particular that Audit Scotland would like to change—presumably for the better—in local government financing? I am not asking for a wish list.

Ronnie Hinds: I was grateful for the opportunity to see the committee's questions in advance, because I would have been completely stumped by that one.

The replacement of capital controls by another system—whether it turns out to be a prudential code or something else—is a fundamental issue. Sometimes people do not perceive the importance of the issue, as it is a very technical matter at the heart of already complex local government finance. However, I cannot overstate its importance and it is very much part of best value. Someone raised the issue earlier of revenue contributions to capital, which is a valid way of financing expenditure. As the Accounts Commission overview report that came out in April pointed out, however, one of the reasons why the incidence of revenue contributions to capital is so high in Scottish local government—particularly on the housing side—is because of capital controls. If we want to maintain higher levels of capital investment—which cannot be done because the capital controls act as a ceiling—we will have to look for other measures and revenue contributions are perfectly legitimate.

As has been said, the downside to the housing revenue account is that current tenants pay for future tenants' benefit. As most people in my profession would say, that is bad accounting practice. To be driven to that because of inadequate levels of capital consent—which is how local government would present the situation—is unfortunate. The system of capital controls that is being discussed, which I hope will apply UK-wide, offers a means of solving that problem, because it will take away the constraint over consent to spend and replace it with another control that is probably adequate—affordability.

If a local authority can afford to raise debt to invest in its housing stock, roads or schools and can prove its ability to afford that through a range of financial plans, the accounts that it produces and the audit that we do, a fairly adequate level of control overall is available. To have an additional control that simply forces local authorities down some avenues might not be the best way of asking them to behave. I hope that the capital controls that we are talking about will have the effect that I expect and that, as a result, there will be more investment and a better balance in investment in local authority services.

The Convener: I thank you very much for giving evidence. I am aware of your study on council tax collection and I have seen some of what you have produced. I was interested in your comments on specific grants. Please correct me if I am wrong—did you say that 25 per cent of specific grants are not subject to external audit?

Ronnie Hinds: That is correct.

The Convener: There is no rhyme or reason as to why one can or cannot audit some grants. We do not know why some are chosen for external audit and some are not.

Ronnie Hinds: It is an accident of history.

The Convener: That is interesting. Your comments about the Scottish Executive testing the effectiveness of PPPs and PFIs are right. The committee has talked about checking and monitoring what happens, not only with such schemes, but with the legislation that the Parliament passes. We have also considered how we check and monitor whether those initiatives are effective.

I thank you for coming along. I am sure that we will see you again and we look forward to your reports on PFI and on council tax collection.

Budget Process 2002-03

The Convener: We proceed now to the budget process. All that I ask committee members to do is accept the proposed approach to the budget process for next week, when Professor Arthur Midwinter will come to advise the committee. We considered the budget at stage 1 in May and reported to the Finance Committee, so we have taken most of the evidence that we want to take.

As the committee is constrained by the time by which we must put our report into the system, I suggest that we hear from the Minister for Finance and Local Government on 2 October. Do members agree to pursue that approach? The committee's work load means that we do not have time to take more evidence than that. Are members happy that we will have Arthur Midwinter along with us next week and that the only person whom we will cross-examine is the minister?

Members *indicated agreement*.

Meeting closed at 15:54.

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