CIPFA The Chartered Institute of Public Finance & Accountancy

The Scottish Parliament Devolution (Further Powers) Committee:

A Submission by:

The Chartered Institute of Public Finance and Accountancy

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the people in public finance

CIPFA, the Chartered Institute of Public Finance and Accountancy, is the professional body for people in public finance. CIPFA shows the way in public finance globally, standing up for sound public financial management and good governance around the world as the leading commentator on managing and accounting for public money.

Further information about CIPFA can be obtained at www.cipfa.org

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1. Executive Summary

1.1 This short submission focuses on borrowing and accountability. CIPFA has previously advocated and fully supports the introduction and implementation of enhanced borrowing powers for Scotland. We consider that any system should be underpinned by a prudential framework which is based on the principles of:

- Affordability;
- sustainability; and
- prudence.

1.2 The draft clauses contained in Annex A of the 'an enduring settlement document'[1] do not however provide for an extension to the existing borrowing powers contained in the Scotland Act 2012 or any additional clauses. We consider this to be an omission given the recommendations made by the Smith Commission in Paragraph 95(5) of their report[2].

1.3 There is of course a cost to borrowing. The borrowing powers which currently exist under the Scotland Act 2012 if fully utilised could result in an annual cost to the Scottish budget of £288m within eleven years. As an indicator of scale, this equates to more than the proposed resource budget for 2015/16 on the full portfolio for Training, Youth and Women's Employment.

1.4 The introduction of enhanced borrowing powers provides an opportunity to improve financial reporting to the people of Scotland at a national level. Enhanced financial information which for the wider Scottish public sector could be developed in the form of a 'balance sheet for Scotland' or a 'whole of Scotland' accounts.

[1] HM Government – Scotland in the United Kingdom: An enduring settlement 22 January 2015
[2] The Smith Commission Report November 2014 https://www.smith-commission.scot/smith-commission-report/

2. The Prudential Borrowing Framework

2.1 CIPFA was at the forefront of the successful implementation of a prudential framework in local government across the United Kingdom. At that time, primary legislation was required to enable the introduction of a prudential framework. For example, the local government sector in Scotland has supporting legislation through the Local Government in Scotland Act 2003 (Part 7)[3]. Supporting regulations then require local authorities to have regard to CIPFA's Prudential Code[4].

2.2 CIPFA would highlight that the main principles behind the prudential framework, as used in Local Government, are the affordability, sustainability and prudence of borrowing decisions. The framework supports improved strategic and asset management planning.

Affordability

2.3 The fundamental objective of affordability is to ensure that capital plans remain within sustainable limits and in particular, to consider its impact on revenue resources and therefore taxation. Setting affordable limits for borrowing within a prudential framework is a specific requirement and helps ensure that the further objectives of sustainability and prudence are addressed.

Sustainability

2.4 The sustainability of public finances underpins the overall UK fiscal framework and is supported by the prudential code. Sustainability of public finances relates to the ability of a government to sustain its current spending, tax and other policies in the long run without threatening government solvency or defaulting on of its liabilities or promised expenditures. With increasing devolution to the Scottish Government, this will bring increased volatility in revenues and the need to ensure the consequences of long-term investment in capital assets through borrowing or public private partnerships are fully understood.

Prudence

2.5 The prudent level of borrowing is linked to ensuring that ensuing debt will only be for a capital purpose. External debt should not, except in the short term, exceed the total of its capital financing requirement. This is a figure that represents the total value of prior year capital that remains un-financed. It is also prudent that treasury management activities are carried out in accordance with good professional practice. Within the

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[3] Local Government in Scotland Act 2003 http://www.legislation.gov.uk/asp/2003/1/part/7

[4] CIPFA's Prudential Code for Capital Finance in Local Authorities 2011

CIPFA Prudential Code, local authorities are required to adopt the CIPFA Treasury Management Code of Practice[5].

2.6 The borrowing levels within the prudential framework are linked to their implications on affordability within the revenue budgets rather than capital budgets. This also helps underpin the longer-term inter-generational affordability and prudence of capital investment plans. This approach is inconsistent with a prescribed limit of £2.2bn as contained in the Scotland Act 2012.

2.7 CIPFA advocates a prudential approach which will provide more flexibility for the Scottish Government to set its own affordable limits within the prudential parameters. This would be consistent with the overall UK fiscal framework as it currently operates across all UK local government. Linking affordability to its impact on revenue budgets is also in keeping with the concepts of Debt to GDP[6] within the overall UK fiscal framework.

The Cost of Borrowing

2.8 CIPFA has undertaken preliminary calculations (appendix 1), which are designed to demonstrate not only the principles of borrowing but also the indicative consequences upon the Scottish Government budget of servicing the debt. We estimate that under the powers which currently exist in the Scotland Act 2012, funds of approximately £230m will be available for the relatively low annual cost (interest only) of £6.1m. By year eleven, the first year of debt repayment, the charge to the Scottish Government budget would increase to approximately £288m[7].

2.9 The previous Scotland Bill Committee recommended that borrowing powers within the Scotland Bill should be increased to £5bn[8]. We have modelled the consequences of servicing debt at a level of £5bn and estimate that achieving that borrowing level over say, a thirty year period would incur interest charges of in excess of £2.3bn.

2.10 The decision to undertake capital expenditure and subsequently pay interest and to repay external debt will represent a significant opportunity cost for the Scottish Government. Clearly, this will come at the expense of service block revenue expenditure. In terms of scale, the charge to the Scottish budget in year eleven would be broadly larger than the proposed

[5] CIPFA's Treasury Management in the Public Services: Code of Practice and cross sectorial guidance notes 2011
[6] Office of Budget Responsibility: Updated charter for budget responsibility, UK Fiscal Mandate https://www.gov.uk/government/news/updated-charter-for-budget-responsibility
[7] Appendix, Table 1
[8] The Scotland Bill Committee, 2011, Session 3

resource expenditure on the full portfolio for Training, Youth and Women's Employment.[9]

2.11 Unlike the clarity with the local government legislation, the draft clauses omission of borrowing powers means that it is not clear upon which income source the borrowing by the Scottish government will be secured.

3. Accountability

3.1 The importance of financial reporting at a total 'Scottish public sector' level has previously been stated by CIPFA[10] and, separately by Audit Scotland[11].

3.2 At present there is no formal 'Whole of Scotland' financial information in place. Given the current powers for borrowing and devolved taxation in the Scotland Act 2012, and with anticipated enhanced powers to come, CIPFA believes that the establishment of a formal process for 'Whole of Scotland Accounts' is a vital step to improve financial reporting.

3.3 Providing for a formal 'Scottish Whole of Government Accounts' would support proper financial scrutiny of the financial position and performance of the Scottish Government and wider public services. This supports and underpins any Scottish Fiscal Framework that is put in place, the management of the sustainability of Scottish finances and also supports the management of the Prudential Borrowing Regime.

3.4 CIPFA also supports the view that a 'Scottish Whole of Government Accounts' would provide a number of other benefits such as:

- A means for lenders to the Scottish Government to assess the financial position and financial management of the Scottish public sector as a whole, thereby affecting the interest charges likely to be incurred for borrowing from these lenders.

- To support long-term financial planning, for instance by providing information to ensure that sufficient liquid assets are available to settle liabilities and help assess the sustainability of current service provision.

- Whole of Scotland Accounts would also be subject to audit and therefore verified and unbiased financial information to demonstrate

[9] The Scottish Government Draft Budget 2015/16 http://www.gov.scot/Publications/2014/10/2706/downloads
[10] CIPFA Report: Scotland's Future in the Balance http://www.cipfa.org/policy-and-guidance/reports/scotlands-future-in-the-balance
[11] Developing Financial Reporting in Scotland – Audit Scotland July 2013 http://www.audit-scotland.gov.uk/utilities/search_report.php?id=2294

Scottish public sector accountability to the Scottish people for the use of taxpayer’s funds.

Appendix 1

Table 1: Maturity Repayment Based on £2.2bn Debt Limit		
Year	**Level of Debt** **£**	**Estimated Charge to the Scottish Budget** **£**
Year one	230,000,000	6,095,000
Year five	1,150,000,000	30,475,000
Year ten	2,200,000,000	58,300,000
Year eleven	2,200,000,000	288,300,000
Year twenty	2,200,000,000	188,300,000

Table 2: Annuity Repayment Based on £2.2bn Debt Limit		
Year	**Level of Debt** **£**	**Estimated Charge to the Scottish Budget** **£**
Year one	230,000,000	26,484,000
Year five	710,639,000	132,418,000
Year ten	1,084,572,000	264,836,000
Year eleven	1,084,572,000	264,836,000
Year twenty	1,084,572,000	264,836,000

Table 3: Maturity Repayment Based on £5bn Debt Limit		
Year	**Level of Debt** **£**	**Estimated Charge to the Scottish Budget** **£**
Year one	230,000,000	6,095,000
Year five	1,221,101,236	32,359,183
Year ten	2,636,692,242	69,872,344
Year twenty	3,543,493,891	394,000,420
Year thirty	5,000,000,000	535,806,392

Note:

For the purposes of calculations we have assumed that the most likely borrowing option would likely be in the form of a NLF loan through the UK Debt Management Office (UKDMO).