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Dear Ms McLellan

### **Consultation on the Role of a Scottish Futures Trust in infrastructure investment in Scotland**

The Institute Members in Scotland Group is pleased to submit a response to this consultation.

The Institute Members in Scotland Group represents over 1,300 members of The Institute of Chartered Accountants in England and Wales (ICAEW) who live and work in Scotland. Our members operate across all sectors of the economy in Scotland, as do all 130,000 members of the ICAEW in the UK and overseas. Our members have experience of the operation of financing schemes for public sector assets both from the contractor and client perspective and members of the Institute have been heavily involved in all aspects of PFI deals across the United Kingdom.

In this response we set out some general observations about the existing approach to infrastructure funding ie the Private Finance Initiative (PFI) and the proposed Scottish Futures Trust (SFT). We then address the specific questions posed in the formal consultation document and finally we discuss how the move to International Financial Reporting Standards might impact upon the SFT.

### **General Observations**

#### **Benefits of the PFI approach**

As the consultation paper itself acknowledges (see section 3.5) the PFI has increased the overall level of capital investment in Scottish public services. In addition the PFI has led to improved efficiency in the delivery of these projects. A study undertaken by the National Audit Office in 2003 noted that almost three quarters of projects procured under traditional methods came in over budget or late. The comparable figure for projects procured via PFI was under 25%.

Furthermore other operational savings and more effective public sector outputs undoubtedly accrue under PFI for example because public services have access to more modern, more efficient and better designed buildings. Critics of PFI are quick to identify excess profits but too often other benefits such as those cited above are overlooked or ignored. Of course these benefits are difficult to identify and there is little agreement as to how they should be measured but this does not mean that they do not exist or that they should be ignored.

### **Disadvantages of the PFI approach**

The most frequently cited disadvantage of the standard PFI approach is that providers can make uncapped, unwarranted and undeserved profits. It has to be conceded that in some cases providers have been able to negotiate unduly favourable deals or alternatively that they have been able to renegotiate deals in a way which allows them to escape adverse consequences.

In our view this is a symptom of a more underlying weakness namely the asymmetry of information between the relatively small number of providers of PFI services who have access to specialist advice and services and the large number of public agencies who contract with these providers to procure assets for use in the provision of public services. Profit maximising organisations will always exploit inefficiencies to increase their return on investment. The way to reduce this is a) to increase the number of potential providers and hence increase competition and b) to enhance the information available to the purchasers.

### **Benefits of the Scottish Futures Trust approach**

As noted above the asymmetry of information associated with the traditional PFI model is its most significant weakness. For this reason we would support the better provision of advice to public authorities considering entering into arrangements for the procurement of public assets. Of course such information is readily available in the market place and individual ICAEW members and member firms (as well as members of other professions) have developed considerable advisory expertise in this market place.

Whilst we would support the creation of a body of knowledge within the SFT that would complement the expertise that already resides within the public sector we would suggest that a significant role for private sector advice was retained. We would also caution that retaining skilled people resources within SFT could prove to be a considerable challenge given the potential rewards available to subject matter experts in the private sector.

We also agree that SFT could usefully provide an advisory service on the scoping and procurement of major deals. There are a large number of procuring public sector entities and it is neither realistic nor possible that every public authority would be able to secure the necessary in house expertise.

Finally we can see considerable benefit in the 'depoliticisation' of this issue. There will of course be a spectrum of opinion that is resolutely opposed to any private sector involvement in the provision of public services but it would be hoped that the spectrum of opinion which currently views the PFI in an unfavourable light might take a more balanced view of the SFT.

### **Disadvantages of the Scottish Futures Trust approach**

Although we feel the SFT has many features that we can support we do have a number of reservations.

The first surrounds the number of different objectives that the Trust is seeking to achieve. In our view there will be considerable difficulty in balancing all these competing objectives in a single entity. For example it is not clear how the same body can simultaneously raise funds, disburse the proceeds and provide independent advice to the potential users of those funds.

The second surrounds the management of the entity. The trust will be a complex undertaking and the board and executive management team of the Trust will need to be highly skilled and qualified. Whilst we note the desire to have a range of stakeholders represented within the Trust we fear it might be difficult to secure an appropriate balance or to ensure that the Trust focuses on its primary goal – the provision of appropriately priced funding for public investment.

Finally we have reservations about the idea that there could or should be a single provider of finance for public sector assets in Scotland. In our view the diverse needs of the public sector are more likely to be satisfied if there is more choice and competition and not less. History suggests that a single provider is very unlikely to contribute the desired level of innovation and variety that would best serve the market.

## **Comments on the Consultation Questions**

### **1. Availability of expertise**

As noted above the asymmetry of information in the current arrangements is a significant weakness in the PFI approach and anything that helps to address this is to be welcomed. However we think the focus should be on correcting the asymmetry by improving the provision of information and not by reducing the number of service providers.

### **2. Advantages/disadvantages of permitting surpluses**

At first glance permitting the use of surpluses would appear to be desirable but in our view this could quickly lead to difficulties. For example which projects would be deemed suitable to be funded from surpluses as opposed to core funds? Would these be seen as more or less 'deserving' projects? Would the generation of surpluses give rise to accusations that the Trust was profiting from its activities? In our view considerable thought as to the possible implications and consequences is needed before surpluses were to be used extensively to fund projects.

### **3. Facilities agreements**

If the proposal here is that the SFT owns public assets which it allows other bodies to use then we can see two practical issues.

The first would be the considerable management undertaking implied in the day to day operational control of these assets which could be both complex and costly.

The second would be whether these assets would be properly maintained and serviced. One of the major advantages of the PFI is that there is a considerable economic incentive for the owner to maintain and service its asset so as to protect and if possible enhance its commercial value. It is far from clear that the SFT model would prioritise this type of ongoing operational spending in the same way.

### **4. Standardisation**

There would be advantages in seeking to use best practice and efficient designs but we would question the underlying implication of the question which is that existing providers do not pursue efficiency goals in the way that the SFT might. In our view private sector providers are just as likely to seek leading edge and exemplar designs.

### **5. Transferring existing public sector assets to the SFT**

We would not support this for the reasons set out in answer 3.

## **Accounting for PFI**

As the consultation paper points out the UK Government has stated its intention to adopt International Financial Reporting Standards in the near future. Our understanding is that the formal introduction of IFRS in the public sector will occur in 2009 but public bodies will need to begin to adopt the international standards so that they can produce comparative figures for accounting periods ending in calendar year 2008.

There is a particular issue in respect of assets used in the provision of public services since it is probable that these assets will need to be recognised in the balance sheets of the ultimate public sector funder – in this case the Scottish Government. The full and precise implications of the move to IFRS are being debated within the accounting profession with many expert observers awaiting with interest the outcome of detailed deliberations being undertaken by HM Treasury. This guidance is expected in the next few weeks and will go some way to clarifying the position. The Treasury guidance should be authoritative and although we recognise that the Scottish Executive and in particular the Scottish Government may wish to formulate the precise structure of any proposed SFT in a way which suits their own circumstances we would encourage a close study of the Treasury guidance when it is produced.

## **Conclusion**

We hope these initial thoughts are of use and have helped to inform the consultation process.

We are happy to provide further input to the consultative process as appropriate, particularly as and when the position with respect to the adoption and impact of IFRS becomes clearer.

Yours sincerely



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