

A REPORT BY THE AUDITOR GENERAL FOR SCOTLAND UNDER SECTION 22(3) OF THE PUBLIC FINANCE AND ACCOUNTABILITY (SCOTLAND) ACT 2000

SCOTTISH EXECUTIVE CONSOLIDATED RESOURCE ACCOUNTS

1. The Scottish Executive consolidated resource accounts incorporate the activities of the seven core departments, the Crown Office and Procurator Fiscal Service, all 13 executive agencies, and NHS bodies in Scotland. I have qualified the consolidated resource accounts of the Scottish Executive for the year ended 31 March 2005 on the regularity of expenditure because the resources used by the Scottish Executive Development and Health Departments exceed the limits authorised by the Budget (Scotland) Act 2004. I have also decided to bring to Parliament's attention the Ministerial written authority which was issued during the year to the Accountable Officer of the Scottish Executive Enterprise, Transport and Lifelong Learning Department, and matters arising in connection with the buy-out of the Skye Bridge PFI contract.
2. I submit these accounts and my report in terms of sub-section 22(4) of the Public Finance and Accountability (Scotland) Act 2000, together with this report which I have prepared under sub-section 22(3) of the Act.

Qualified opinion on the regularity of expenditure – Development Department

3. In 2004/05 the Scottish Executive Development Department (SEDD) provided funding for the early repayment of all of Scottish Homes' outstanding loans to the National Loans Fund. At the time of compiling the Autumn Budget revision to the Budget (Scotland) Act 2004, SEDD provided for the interest and early redemption premium but not for the early repayment of principal amounting to £101 million.
4. The Scottish Executive considered at the time that provision in the Budget (Scotland) Act 2004 for the early repayment of principal was not required because the grant in respect of the principal repayment was to be funded from a balance in the Scottish Consolidated Fund. The Scottish Executive now accepts that the early repayment of principal also represents a use of resources.
5. As a result, SEDD's use of resources for 2004/05 amounted to £1,331 million against a total provision of £1,263 million in the Budget (Scotland) Act 2004 and subsequent amendments. This means that it did not have parliamentary approval for £68 million of expenditure on a use of resource basis and the excess expenditure must, therefore, be deemed irregular.

Qualified opinion on the regularity of expenditure – Health Department

6. As at 1 April 2004 the remaining 18 NHS Trusts were dissolved and their assets and functions transferred to their local NHS Boards. Prior to this, NHS Trusts paid their capital charges to the Scottish Executive Health Department's (SEHD) and the funding of Boards included an element to allow Trusts to repay capital charges to SEHD. After the dissolution of Trusts, there was no longer any requirement to pay these charges to SEHD.
7. SEHD recognised that it had to consider the effect of the dissolution of Trusts and of the removal of the circular flow of capital charges income on its 2004/05 budget. The external auditors' 2003/04 management letter also advised SEHD to make suitable provision in the Budget (Scotland) Bill for 2004/05 for the loss of capital charges income arising from the dissolution of the remaining 18 Trusts. SEHD stated it had fully considered the effect of the removal of the circular flow of capital charges income and this was taken into account in the Budget (Scotland) Act 2004. It considered that there would be no loss of income to SEHD as the income and expenditure elements of the capital charges would net each other off. It appears that SEHD considered the effect of the dissolution but came to the incorrect conclusion regarding the resource impact of the loss of income relating to cost of capital and depreciation charges. Consequently, funds were over-allocated to the NHS.
8. As a result, SEHD's use of resources for 2004/05 amounted to £6,597 million against a total provision of £6,565 million in the Budget (Scotland) Act 2004 and subsequent amendments. Therefore the SEHD did not have parliamentary approval for £32 million of excess expenditure on a use of resource basis and the expenditure must, therefore, be deemed irregular.

Ballycastle to Campbeltown Ferry Service

9. In March 2005, the Scottish Executive and the Northern Ireland Executive announced a renewed attempt to seek offers from shipping operators for a contract to provide a passenger and vehicle ferry service between Ballycastle and Campbeltown for 11 months of the year. The invitation to tender, issued in September 2005, proposes a five-year contract with a maximum annual subsidy of £1 million and the option to add other routes around the subsidised service.
10. A previous tender exercise in 2002 with the same subsidy on offer failed to find any bidders. At the time, the Accountable Officer and Head of Scottish Executive Development Department asked for written authority from Ministers to proceed with the tendering because analysis by consultants indicated that the subsidy on offer exceeded the expected economic benefits arising and the subsidy did not represent value for money.
11. In March 2005 the Accountable Officer and Head of Scottish Executive Enterprise Transport and Lifelong Learning Department sought similar written authority to proceed with the tendering exercise for the same reasons as the previous tender exercise. The Scottish Ministers issued the authority on 31 March 2005 but no expenditure has been incurred to date. In line with my usual practice I am bringing this matter to the attention of Parliament because written authority has been issued, and I will monitor progress in awarding this service.

Buy-out of the Skye Bridge PFI Contract

12. The 1991 contract between the Secretary of State and Skye Bridge Ltd did not enable the Scottish Executive to terminate the Concession Agreement as of right. A right of termination subject to defined compensation is now standard for PFI contracts.
13. Scottish Ministers and Skye Bridge Limited reached an agreement in December 2004 to end the collection of tolls on the Skye Bridge in return for a lump sum termination payment to Skye Bridge Ltd in order to meet a 2003 policy commitment. In accordance with HM Treasury guidance, the Scottish Executive were required to negotiate a termination payment which left Skye Bridge Ltd in a similar financial position to that it would have been in had the contract ran its full course. The Scottish Executive obtained financial advice on the costs of the options open to it for terminating the Concession Agreement.
14. One option was to terminate the concession by change of law which the Scottish Executive's advisors considered could cost £24.0 to £27.2 million. The Scottish Executive rejected this option because, in addition to uncertainty about cost, it would require primary legislation, could be a lengthy process and it considered that seeking legislation to terminate a contract could affect the general willingness of others to enter into PFI contracts. The option chosen was to negotiate a voluntary compensation package with Skye Bridge Limited. The eventual agreed compensation of £26.7 million was at the upper end of the £21-£27 million range which the Scottish Executive's advisors deemed reasonable.
15. The chosen termination route was less than the estimated cost to users of allowing tolls to continue (£38 million). But, after allowing for the taxes that Skye Bridge Ltd would have paid to the UK Exchequer had it continued to operate, the net cost to public funds and users was neutral whether the tolls continued or the buy-out went ahead. I am bringing this matter to the attention of Parliament because this was the first buy-out of a PFI contract in the UK, and I will continue to monitor significant PFI contracts.



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