FINANCE COMMITTEE

AGENDA

31st Meeting, 2004 (Session 2)

Tuesday 30 November 2004

The Committee will meet at 9.30 am in Committee Room 6 to consider the following agenda items:

1. **Scottish Parliament Holyrood Building:** The Committee will consider correspondence from the Presiding Officer and take evidence from—

   Paul Grice, Clerk and Chief Executive; Paul Curran, Project Head, Holyrood Project Team; and Dave Ferguson, Holyrood Project Adviser, Scottish Parliament;

   Robert Brown, MSP, Member, Scottish Parliamentary Corporate Body.

2. **Cross Cutting Expenditure Review on Economic Development:** The Committee will take evidence from—

   Jack Perry, Chief Executive; and Charlie Woods, Senior Director of Knowledge Management, Scottish Enterprise;

   Sandy Cumming, Chief Executive; and Sandy Brady, director, strategy, Highlands and Island Enterprise;

   Angiolina Foster, Chief Executive; and Ian Mitchell, Acting Director of Regeneration, Communities Scotland;

   Martin Briggs, Chief Executive, East Midlands Development Agency;

   Rosemarie Davies, Business Support Partnership Director; and Kevin O'Leary, Head of Support Services, Welsh Development Agency.

3. **Budget Process 2005-06:** The Committee will consider the Scottish Commission for Public Audit’s report on Audit Scotland’s expenditure proposals for 2005-06.

4. **Item in private:** The Committee will decide whether to consider its draft report on the Budget Process 2005-06 in private at future meetings and whether to consider its draft report on the Financial Memorandum of the Gaelic Language (Scotland) Bill in private at its next meeting.
The papers for this meeting are:

**Agenda Item 1**

Correspondence from the Presiding Officer, dated 25 November 2004

**Agenda Item 2**

Written evidence

PRIVATE PAPER

**Agenda Item 3**

Briefing paper by the Clerk

PRIVATE PAPER – to be published as a public paper 26 November 2004
Dear Des

HOLYROOD REPORT, NOVEMBER 2004

This is my twelfth report on the Holyrood building, providing the Finance Committee with the latest information on the Project cost and programme. This is the second report since the Parliament’s migration to the new building took place and deals with progress since I last wrote to you on September 13th.

The Royal Opening of the building took place on 9 October 2004 and I hope the Committee agrees that it proved to be a considerable success. Outstanding works progressed well around that date. The Parliament continues to settle in well in our new home at Holyrood.

Key points this month:

1. There is no change to the overall cost reported in September. This remains at £430.5m.

2. Since the September report, just over £3m has moved from ‘construction reserve’ into ‘construction commitment’, over two thirds of which has been allocated to the Assembly Windows and Specialist Glazing packages. Some £4.4m has moved from the unallocated ‘programme contingency’ into ‘construction reserve’, to cover anticipated additional expenditure on general site organisation costs, including; mobile crane hire; insurances; clearing the site of temporary works and cabins; site security; and BLL staffing and accommodation costs for 2004 and 2005. Over the same period, £5.3m has
moved the other way, from the ‘construction reserve’ to the ‘programme contingency’, where the risk associated with the individual packages is unlikely to materialise. The net effect of all the movements since the last report is reflected in the table at Annex A.

3. Works to rectify the defective windows have now commenced, with completion scheduled by the end of January 2005. All costs associated with this defect will be paid for by the Trade Contractor.

**Snagging**

Bovis have prepared a programme for closing out snagging on a detailed, geographic, level by level basis. Good progress is being made in line with my previous advice on snagging and commissioning works. Works will continue to be carried out, as far as possible, outwith Parliament business hours.

**Landscaping**

Landscaping works are almost complete. Tree planting will commence at the end of November, with all other outstanding works completed by Christmas.

**Final Accounts**

The Holyrood Project Team (HPT) under Paul Curran will continue to focus attention on achieving the best financial settlements possible on all Trade Package contracts. The team has been strengthened by the addition of a specialist claims manager and project managers have access to the Parliament’s legal and technical Directorates. Where appropriate, external legal and professional advice will be sought.

This is a difficult and lengthy process but the HPT is working rigorously with DLE and Bovis to try to minimise the overall cost of the project. I remain committed to keeping colleagues advised of progress until financial completion is achieved.

**Post Completion Advisory Group**

The SPCB has also established the Post Completion Advisory Group to assist the HPT and the Clerk in this critical stage of the project. The Group will provide advice on the processes for the handling of claims; final accounts settlements; and the architectural integrity of the building. The Group comprises Andrew Wright, David Manson and John Gibbons, previously professional members of the Holyrood Project Group; Brian Eggleston, a specialist in Mediation and Arbitration and currently President of the Chartered Institute of Arbitrators; and Dave Ferguson, who convenes the Group. The SPCB considers that the Group provides the essential blend of independence and experience of the project required at this stage. As well
as providing advice where appropriate, the Group will exercise the challenge function to recommendations of Project Management.

The Group’s proposals on a strategy for the settlement of final accounts, has recently been approved by the SPCB.

Yours sincerely

GEORGE REID

Encl: financial summary annex.
<table>
<thead>
<tr>
<th></th>
<th>Range Low End</th>
<th>Range High End</th>
<th>Change at This report</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>MAIN PROJECT</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Site, demolition and archaeology</td>
<td>5.7</td>
<td>5.7</td>
<td></td>
</tr>
<tr>
<td>Fit Out</td>
<td>19.5</td>
<td>19.5</td>
<td></td>
</tr>
<tr>
<td>Current construction commitment</td>
<td>250.9</td>
<td>250.9</td>
<td>plus 3.04</td>
</tr>
<tr>
<td>Fees (capped lump sum)</td>
<td>50.3</td>
<td>50.3</td>
<td></td>
</tr>
<tr>
<td>Site organisation costs</td>
<td>17.5</td>
<td>17.5</td>
<td></td>
</tr>
<tr>
<td>VAT on current commitment</td>
<td>43.9</td>
<td>43.9</td>
<td>plus 0.53</td>
</tr>
<tr>
<td>Construction reserve</td>
<td>9.5</td>
<td>12.5</td>
<td>less 3.04 less 0.94</td>
</tr>
<tr>
<td>Estimated VAT on reserve</td>
<td>1.7</td>
<td>2.2</td>
<td>less 0.53 less 0.16</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>399.0</td>
<td>402.5</td>
<td>less 1.10</td>
</tr>
<tr>
<td><strong>LANDSCAPING</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Muster room transfer</td>
<td>0.5</td>
<td>0.5</td>
<td></td>
</tr>
<tr>
<td>Land purchase</td>
<td>0.3</td>
<td>0.3</td>
<td></td>
</tr>
<tr>
<td>Construction works</td>
<td>12.8</td>
<td>12.8</td>
<td>plus 2.32m</td>
</tr>
<tr>
<td>Fees (including site mgt)</td>
<td>1.9</td>
<td>1.9</td>
<td></td>
</tr>
<tr>
<td>Construction reserve</td>
<td>0.6</td>
<td>0.6</td>
<td>1.0m less 2.32 plus</td>
</tr>
<tr>
<td>VAT</td>
<td>2.6</td>
<td>2.6</td>
<td>plus 0.17m</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>18.7</td>
<td>18.7</td>
<td>plus 1.17m</td>
</tr>
<tr>
<td><strong>SUBTOTAL</strong></td>
<td>417.7</td>
<td>421.2</td>
<td></td>
</tr>
</tbody>
</table>

**Risk drawn down from 'Construction Reserve':**
- Assembly windows: 1,500,000
- Fire alarm & protection: -46,083
- Mechanical & Plumbing East: 155,295
- Commissioning management: 175,000
- Lifts: 53,917
- West Electrical: 162,500
- Security: -116,417
- General Builderswork: 225,000
- Assembly Building Concrete Frame: 182,000
- Specialist Glazing: 700,000
- Stone Cladding: 50,000

**Net Total**: 3,041,212

**VAT**: 532,212

**Total**: 3,573,424

**Movement from Contingency to reserve**
- Screed / Stone Floors - Vetter: -415,000
- Stainless Steel Interface - Baydale: -250,000
- East Superstructure - O'Rourke: -118,000
- Stone Cladding - Watson: -450,000
- Zone 3 Fit Out - Ultimate: -400,000
- East Electrical - FES: -800,000
- Bovis Site Org Costs: 4,396,337
- East Electrical - FES: -2,902,199

**Net Total**: -938,862

**VAT**: -164,301

**Total**: -1,103,163

**Risk drawn down from 'landscaping Reserve':**
- Hard Landscaping: 1,965,268
<table>
<thead>
<tr>
<th>Accounts Settled To Date</th>
<th>Cost Plan</th>
<th>Inflation</th>
<th>Final settlement</th>
<th>Explanation for Increase</th>
</tr>
</thead>
<tbody>
<tr>
<td>QH Demolition/Reconstruction - Ballast</td>
<td>3,100,000</td>
<td>350,000</td>
<td>4,250,000</td>
<td>Prolongation/QH Condition</td>
</tr>
<tr>
<td>Roads - Hewcon</td>
<td>800,000</td>
<td>-</td>
<td>1,050,736</td>
<td>Unforeseen Ground Conditions</td>
</tr>
</tbody>
</table>

**Programme contingency (incl. VAT)**

|               | 6.9 | 9.2 | less 0.07 |

<table>
<thead>
<tr>
<th>Soft Landscaping</th>
<th>351,000</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Net Total</strong></td>
<td>2,316,268</td>
</tr>
<tr>
<td>VAT</td>
<td>405,347</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>2,721,615</td>
</tr>
</tbody>
</table>

**Movement from Landscaping Contingency to Reserve**

| Hard Landscaping | 500,000 |
| Soft Landscaping | 500,000 |

| **Net Total**    | 1,000,000 |
| VAT              | 175,000   |
| **Total**        | 1,175,000 |
Finance Committee

31st Meeting 2004 – Tuesday 30 November 2004

Cross Cutting Expenditure Review on Economic Development – Written Evidence

1. The Committee has received submissions from the following organisations as part of its Cross Cutting Expenditure Review on Economic Development:
   - East Midlands Regional Development Agency
   - Welsh Development Agency
   - Highland and Islands Enterprise
   - Scottish Enterprise
   - Communities Scotland

2. The Committee is invited to note these submissions.

Terry Shevlin
Finance Committee
Background To English Regional Development Agencies
English Regional Development Agencies (RDAs) were set up by Government (RDA Act 1998) to promote sustainable economic development in England. They are business led. Their main tasks are to help the English regions improve their relative economic performance and reduce social and economic disparities within and between regions.

A regional approach to economic development allows businesses and communities to formulate solutions that are appropriate for the particular circumstances and strengths of each region.

How are RDAs structured?
Each RDA is led by a Chair and a Board of 15 people. With the exception of London, where appointments are made by the Mayor, board members, including the Chair are appointed by DTI Ministers. RDA Chairs are successful business people with a track record of working within their region and understanding the needs of regional business and society. RDA Boards are made up of a wide mix of senior stakeholders within the region including local Government, the voluntary sector, trade unions and local businesses.

The day to day management of each RDA is led by its Chief Executive who is appointed by the Board, subject to approval from Ministers or in London the Mayor. Chief Executives are the Accounting Officer for their RDA. In London the accounting officer is the Chief Finance Officer. As RDAs are independent, the staffing structure of each is different, depending on the needs and priorities of each region.

Who do they report to?
Formally RDAs report to DTI (Department of Trade and Industry) Ministers and in London the Mayor. But the work that they do is central to, and funded by, ODPM (Office of the Deputy Prime Minister), HM Treasury, DEFRA (Department for Environment, Food and Rural Affairs), DfES (Department for Education and Skills) and DCMS (Department for Culture, Media and Sport), so DTI Ministers work with their colleagues to ensure that the RDAs are delivering across the board. Targets are agreed which reflect the contribution that RDAs make to a number of Departmental PSA targets and allow the RDAs the flexibility to develop solutions to fit their region. In London the targets for the LDA are set by the Mayor and central Government. Detailed reports of how the RDAs are delivering are compiled every six months between the RDAs and Government Offices. Government Offices provide an annual assessment of each RDAs performance to Ministers.

Additional accountability is provided within the region through Regional Assemblies. At the moment, these are voluntary bodies in each region that scrutinise the work of their RDA. If any region votes in favour of a directly elected assembly in a referendum then the RDA in that region will become directly accountable to the assembly. In London, the LDA is accountable to the Mayor and the London Assembly.
What do they actually do?
Immediately they were set up, each RDA was required to work with its partners in the region to draw together a Regional Economic Strategy to set out for the whole region how the RDAs statutory objectives would be met and the region developed.

These strategies are owned by the whole region, not just the RDA. Importantly, they provide the context for all other economic development and regeneration activity in the region and provide Departments with a framework that sets out the direction that their policies in that region should support.

These are reflected in the regional emphasis documents that each region prepared for the Spending Review. These have enabled Departments to consider the impacts that their policies will have in the regions over the next spending period.

What's in a Regional Economic Strategy?
Whilst each Regional Economic Strategy reflects the needs and opportunities of its region and is therefore unique, they all contain the following elements:

- a vision for the strategic development of the region over at least the next ten years;
- the main priorities for development and action to deliver this vision;
- analysis of the strengths, weaknesses, threats and opportunities that the region faces;
- information on the region and its economy and the key relevant Government policies for developing the region.

Where does the money for the RDAs come from?
Since April 2002, RDAs have been financed through a Single Programme. Monies from the contributing Departments (DTI, ODPM, DfES, DEFRA and DCMS) are pooled into one single budget. The funding, once allocated, is available to the RDAs to spend as they see fit to achieve the regional priorities identified in their Regional Economic Strategies and the challenging targets set by them in their Corporate Plans.

<table>
<thead>
<tr>
<th>Regional Development Agencies (contributions to single pot) £ million</th>
<th>2004-05</th>
<th>2005-06</th>
<th>2006-07</th>
<th>2007-08</th>
</tr>
</thead>
<tbody>
<tr>
<td>Department of Trade and Industry</td>
<td>234</td>
<td>463</td>
<td>476</td>
<td>483</td>
</tr>
<tr>
<td>Office of the Deputy Prime Minister</td>
<td>1,511</td>
<td>1,568</td>
<td>1,633</td>
<td>1,676</td>
</tr>
<tr>
<td>Department for Environment, Food and Rural Affairs</td>
<td>46</td>
<td>72</td>
<td>73</td>
<td>74</td>
</tr>
<tr>
<td>Department for Education and Skills</td>
<td>42</td>
<td>43</td>
<td>44</td>
<td>45</td>
</tr>
<tr>
<td>UK Trade International 2</td>
<td>13</td>
<td>13</td>
<td>13</td>
<td>13</td>
</tr>
<tr>
<td>Department for Culture, Media and Sport</td>
<td>2</td>
<td>6</td>
<td>6</td>
<td>6</td>
</tr>
<tr>
<td>TOTAL</td>
<td>1,847</td>
<td>2,163</td>
<td>2,244</td>
<td>2,297</td>
</tr>
</tbody>
</table>

1- Note: Figures may not sum due to rounding
2- It is expected that UKTI’s contribution to the Single Pot will increase by 2007-08.
What targets are set for RDAs?

Regional Development Agencies’ reported outputs for the financial year 2003/2004:

<table>
<thead>
<tr>
<th>Category</th>
<th>Target</th>
<th>Achievement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employment opportunities</td>
<td>59,296 jobs</td>
<td>89,694 jobs</td>
</tr>
<tr>
<td>Business performance</td>
<td>4,145</td>
<td>6,064 businesses</td>
</tr>
<tr>
<td>Brownfield land</td>
<td>1,035.43 hectares</td>
<td>1,202.41 hectares</td>
</tr>
<tr>
<td>Education and skills</td>
<td>100,061 learning opps.</td>
<td>194,380 learning opps.</td>
</tr>
<tr>
<td>Private sector investment in deprived areas</td>
<td>£571.90m</td>
<td>£676.69m</td>
</tr>
</tbody>
</table>

**SUBMISSION FROM THE WELSH DEVELOPMENT AGENCY**

**Introduction**

This report outlines briefly the role of the Welsh Development Agency (WDA) and its current and future business support priorities.

The WDA, established in 1976, is a Welsh Assembly Government sponsored public body, providing development support to businesses, individuals and communities across Wales. The activities of the WDA can be grouped into three areas:

- Support for potential, new and existing businesses, including the social economy
- Attracting and retaining inward investment
- Provision and support for infrastructure development including property, regeneration and land reclamation

Finance Wales, a bank providing loan, equity and mezzanine finance for Welsh businesses is a wholly owned subsidiary of the WDA. Much of the focus of this report will be on the support provided to indigenous businesses.

There has been a long tradition of the Welsh Assembly Government, ASPBs (Assembly-sponsored Public Bodies) and Local Authorities acting on a ‘Team Wales’ basis, to co-ordinate public sector economic development activities. As a natural extension to this, on July 14th 2004, the Welsh Assembly Government announced the decision to merge three of its ASPBs (WDA, Education and Learning Wales (ELWa) and the Wales Tourist Board) into the sponsor body. This will provide a clear and consistent approach to the delivery of public services and increase the effectiveness of Team Wales. The merger is scheduled to take place in April 2006.

**Economic Development Activities**

Wales has a population of 2.9m. The estimated total business stock is circa 170,000 with 75,000 VAT registered businesses dominated by SMEs. Large areas of Wales have Objective 1 status with much of the rest of the country falling in an Objective 2 or Transitional area.
In the on-going work to further improve the delivery of business support in Wales three aspects have been identified:

- Building and developing healthy business foundations – this involves broad-brush, cultural change, capacity building and business best practice work. Its purpose is to stimulate and reactively support business growth and competitiveness, entrepreneurship, innovation and information society participation amongst the full range of SMEs. It is long term investment in the health of the business infrastructure in Wales.
- Proactively targeted, discretionary, tailored support to meet the specific needs of high potential businesses – this is selective and intensive support, typically for knowledge economy or key sector businesses, which seeks a higher, more precisely tracked and measured return on public sector investment.
- Corporate relationship management with major investors to anchor, maintain and develop large scale investment in Wales.

Currently, the Agency’s offering to business customers is presented under the following six strands of support:

- Help with industry networking and support for sectoral fora
- Information and signposting to all support (public, private and voluntary sector) through the free and impartial Business Eye service available to all businesses in Wales
- General advice, account management and mentoring, providing customer focused, general advice.
- Specialist Support including structured sector and subject specific programmes and the more flexible approach under development to provide bespoke consultancy solutions.
- Brokering support providing various forms of for help with supply and procurement including ‘meet the buyer’ events and a public sector procurement initiative.
- Access to Finance through Finance Wales offering a range of funds from HE spinout and micro-loans to larger equity expansions.

Because of the critical importance of innovation, significant investment is being made to move Wales towards a more knowledge-based economy and raise the level of R&D expenditure. Activities range from awareness of the importance of innovation, development of industry – academia links, commercialisation and innovation grants such as SMART.

Similarly, help is provided to move businesses up the ‘ecommerce ladder’ coupled with actions to create an environment that enhances and increases the demand for ICT, such as increased access to broadband.

Farming and agri-food businesses benefit from a range of tailored programmes from direct financial support through to market development and support for the promotion of Welsh foods.
In addition to the Agency’s work with existing businesses, creating a culture of entrepreneurship is a key priority. This includes promotional and cultural change activities and help to start a new business. Addressing the drive for equality and diversity, additional help is provided for under represented groups along with ‘mainstreaming’ diversity issues.

Ten key sectors have been identified in Wales and these will form a priority for future investment. They include: electronics, automotive, aerospace, creative industries, construction, agri-food, social care, tourism, chemicals/pharmaceuticals/bioscience and financial services.

Support for businesses seeking to export is provided by the Welsh Assembly Government through Trade Invest Wales. Capital support (building and equipment) and job creation grants through AIG and RSA are also provided by the Welsh Assembly Government.

**Delivery Arrangements**
The majority of services to businesses are delivered on a local basis to ensure ease of accessibility and focus on customer service. To facilitate this, the Agency has four regional offices that either directly deliver or manage the delivery of the majority of services. A significant proportion of services are contracted to private sector providers.

The importance of the monitoring and tracking of activity and outcomes is well recognised. The Agency operates two client management systems (CMS): one used for internal customer delivery staff and the other used for services that are contracted out. A new monitoring system has recently been introduced which links IT systems for business planning, financial systems and output tracking.

**Economic Development Expenditure and Targets**
Total expenditure by the Agency in 2003/04 was £312m. Income is made up from Welsh Assembly Government core grant in aid and ring-fenced funding, EU structural funds and receipts.

<table>
<thead>
<tr>
<th>Broad Fields of Expenditure*</th>
<th>2004/5 Budget ('000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business Support</td>
<td>£126,691</td>
</tr>
<tr>
<td>Inward Investment</td>
<td>£6,845</td>
</tr>
<tr>
<td>Land and Property</td>
<td>£137,470</td>
</tr>
</tbody>
</table>

*Excludes Agency management costs.

<table>
<thead>
<tr>
<th>Strategic Outputs 2003/04</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Jobs Created</td>
<td>26,900</td>
</tr>
<tr>
<td>Jobs Safeguarded</td>
<td>26,000</td>
</tr>
<tr>
<td>Capital Investment</td>
<td>£874.9m</td>
</tr>
<tr>
<td>Private Sector Investment</td>
<td>£272.1m</td>
</tr>
<tr>
<td>New business Starts</td>
<td>6,760</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Operational Outputs 2003/04</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Businesses given advice and support</td>
<td>23,100</td>
</tr>
<tr>
<td>New business floorspace created</td>
<td>206,800</td>
</tr>
</tbody>
</table>
R&D funding secured for business £37.4m
Industry / Academia collaborations achieved 770
New products and processes under development 2,440
Land reclaimed / improved 132Ha

Key Issues and Emerging Priorities
Much work is currently being undertaken to ensure optimum advantage from the merger of the WDA with the Welsh Assembly Government, with particular focus being placed on customer focussed business support delivery arrangements.

In moving forward a number of priorities have been identified as follow:

- Ensuring clarity and simplicity for any business seeking support and focusing delivery on the customers’ specific needs. A stronger priority will be placed on an ‘account management’ relationship, working with businesses to identify the right support packages at the right time. Effective ‘joined up’ working across all organisations will be essential to achieving this.
- The effective use of the private sector market for the delivery of services. This is being achieved through:
  - Increased direct referrals from Business Eye
  - Contracted core activities such as new business starts support and
  - Supporting businesses, both financially and with management core competencies, to access and make best use of specialist support direct from the open market through the Shared Investment Fund
- In maximising the use of the private sector, approaches are being adopted which aim to minimise the level of market intervention.
- Improving the quality of delivery through both ‘push’ (market forces) and ‘pull’ (infrastructure development/CPD). Through new specialist support arrangements currently under development, businesses will be equipped with skills and support to procure wisely and to manage consultancy relationships. In this way, Business Support investment, at the same time as providing bespoke support to businesses, will develop more intelligent consumer demand to drive up quality in the business support market.
- To drive up the quality in the less consumer-driven elements of the market, tighter contractual relationships are being employed and, in partnership with ELWa, significant investment is being made in assessment centres and continual professional development.
- In order to maximise the return on public sector investment, different levels of support are being applied, with higher levels of intervention for those businesses considered to have the highest potential. The proposed Knowledge Bank will focus resources on the high potential knowledge economy businesses with a drive to improving innovation and competitiveness.

SUBMISSION FROM HIGHLANDS AND ISLANDS ENTERPRISE (HIE)

Introduction
The Highlands & Islands Enterprise (HIE) Network, comprising the core based in Inverness and Linicleat, ten Local Enterprise Companies (LECs) and the Careers
Scotland locality offices, is the Scottish Executive’s economic and social development agency for the north-west of Scotland. The HIE area covers just over half of the landmass of Scotland, yet includes only 9% of the national population.

HIE welcomes the opportunity to submit evidence to the Finance Committee’s expenditure review, precisely because the cross-cutting nature of economic development itself means that an evaluation of the effectiveness of public spending needs to take account of both direct and indirect interventions. With the Partnership Agreement having identified economic development as of the highest priority, the review is timely and should lead to a greater understanding of the importance of economic development assistance measures to raising prosperity levels across Scotland.

The Strategic Context
Following the national launch of A Smart, Successful Scotland in early 2001, we produced “A Smart, Successful Scotland – the Highlands & Islands Dimension” to develop in more detail how the priorities would be delivered in the HIE area with its distinctive challenges. That document, which the First Minister launched in Benbecula in April 2002, has been widely circulated throughout the Highlands & Islands and has ensured that the key messages of A Smart, Successful Scotland and their implications for the activities of the HIE Network have been disseminated to our key stakeholders. The priorities have been instrumental, for example, in helping to shape a number of significant projects seeking funding under the EU Highlands & Islands Special Transitional Programme.

A Smart, Successful Scotland has been widely recognised, both in Scotland and further afield, as a comprehensive, yet succinct, expression of what is required to achieve sustained economic progress in an internationally-small country dependent on its trade connections. The combination of a series of focussed priorities under three strategic – but crucially inter-related – objectives reflects the very broad, but closely-integrated, approach to economic and community development which the HIE Network has always espoused. In terms of the Scottish Executive’s current exercise to refresh A Smart, Successful Scotland, we therefore support the need to retain the overall thrust, refreshing those areas where circumstances have evolved or where greater focus is now necessary.

The Highlands & Islands – A Generation of Progress
Since the mid-1960s the economic fortunes of the Highlands & Islands have turned round remarkably, following a century or more of decline. Many factors contributed to the recovery process, including the establishment of the Highlands & Islands Development Board, government support for rural areas generally, the boost provided by the exploitation of North Sea Oil and, not least, a change in the way in which people viewed the attractiveness of the area as one in which to live and work. The clearest picture of how dramatic the change has been comes from the growth of population and jobs in the last 30 years: the population of the Highlands & Islands has grown by around 20%, while the number at work has gone up by nearly 50%.

The underlying story behind those statistics is a heartening one for remote, rural areas everywhere. Progress has been achieved across all parts of the Highlands & Islands during this period and in many areas has been sustained throughout. Orkney
and Shetland have benefited continuously from the impact of oil-related activities, including the terminals at Sullom Voe and Flotta. The Moray Firth area has enjoyed similar progress, originally generated by oil, and driven by economic diversification, the growth of the city of Inverness and major infrastructure improvements such as the A9. Oil-related employment has also helped the economies of the Western Isles, West Ross & Skye and Dunoon & Bute, albeit on a more short-lived basis.

Steady expansion in locally-based activities such as salmon farming, tourism, food processing, small-scale manufacturing and services have contributed to economic growth in many rural and island areas. These include Skye, Mull, Arran, West Ross and Mid-Argyll. At the same time, the towns of the Highlands & Islands have all grown in population as housing and services development have led to consolidation – typified by Lerwick, Kirkwall, Stornoway, Fort William and Oban. Progress has not, however, been achieved universally, with some remote areas continuing to exhibit the symptoms of decline which once characterised large parts of the Highlands & Islands. Special efforts to turn round the fortunes of such areas continue.

Perhaps the most striking feature of the period is the range of new business activities which have sprung up in an area whose economic base was so narrow just 30 years ago. Freezer manufacture, microchip production, jewellery, healthcare products, high-quality food, teleservice businesses and, most recently, assembly of renewable energy devices testify to the attractiveness of the Highlands & Islands, notwithstanding the external perception of remoteness and high transport costs. The reality is that concerted effort has steadily overcome the traditional obstacles to economic progress facing a sparsely-populated remote area.

Over that same period, we have benefited enormously from the modernisation of infrastructure. The region’s major roads have been improved, most notably the complete reconstruction of the A9. Modern car ferries have replaced lift-on, lift-off vessels and air services have benefited from new aircraft and airport upgrading. Cultural renaissance has also taken place, including measures to stimulate the Gaelic language (eg Gaelic-medium education). Equally, the arts have flourished, both in terms of the provision of infrastructure and also in the stimulation given to artists. The Scottish Year of Highland Culture 2007 now offers a huge opportunity to present the range of this progress to a national and international audience.

Lessons Learned

There are a number of very important lessons to be learned from the progress achieved. These are vital if we are to maintain the momentum of that success and to focus economic development efforts on those parts of the Highlands & Islands which have so far not benefited fully from the overall trends.

The importance of a strategic approach to development is very clear. A number of key regional imperatives have been tackled over the last three decades, notably in the improvement of all forms of infrastructure. Geographical targeting of effort has also been important, with the HIE Network and the local authorities giving particular attention to the needs of the most remote and fragile communities. Local Enterprise Companies have allowed prioritisation and delivery at the local level to ensure that the differences between parts of the area are fully recognised and reflected in the development effort. Community involvement in the process has been integral to
success, since confidence at the local level in the sustainability of economic improvement can be both cause and effect of development.

Key to that approach, in turn, has been the integration of effort across economic, skills, community and environmental activities, enabling the needs of localities to be looked at in the round and addressed appropriately. Partnership working has been essential to ensure that that integration of effort has taken place and has helped to achieve very good value for money from the investment of both public and private sector resources. Perhaps the most significant lesson to be learned, however, lies in the importance of applying development measures consistently over a long period of time. It is to the credit of the many bodies and individuals who have been involved in what has happened in the Highlands & Islands in the last 30 years or so that a generally shared vision of how to turn round the area’s fortunes has pervaded their efforts.

**Challenges Facing the Highlands & Islands**

There clearly remain several key economic development challenges facing the Highlands & Islands. First, and most obviously, we have to hold on to the gains we have made. This means working very closely with our business community to ensure the long-term survival and prosperity of the many businesses which make up the cornerstones of our economy. As forces of international competition impact more and more on even the most local trading, we need to ensure that these businesses respond to the challenge and work towards enhancing their competitiveness.

Those wider forces include the inevitable pressures of consolidation. So many operations, whether they are multinational companies, family-owned enterprises, health trusts, local authorities or enterprise bodies, can apparently undertake their activities more profitably by achieving economies of scale and consolidating physical effort on the ground. That consolidation does not, however, imply centralisation and we have, perhaps for the first time ever in the Highlands & Islands, the technological ability to foster widely-dispersed activity throughout the area. The examples of it which we already have show that we actually possess a number of natural advantages over more urban areas in delivering high-quality services.

Reflecting on the continuing difficulties facing our fragile areas, there is no doubt that our most significant challenge in terms of individual communities is to reverse the decline in these areas, as we have managed to achieve in places like Skye in the last generation. It must be underlined that in an area comprising more than half of Scotland we do have to attempt to achieve better use of the land resource for local people. That is why land reform legislation and the movement towards community ownership are so important.

The largest single project on which we are currently embarked is of course the UHI Millennium Institute. For many of our predecessors the notion of a university in the Highlands & Islands was seen as an ambitious pipe dream. We stand on the threshold of making that university a reality, but it needs to be a very special institution, unique in its dispersed collegiate architecture, but no less committed than any other university to the pursuit of excellence in its academic standards. No single project can make a bigger long-term difference to the future of the area and we must
spare no effort to ensure that its full potential is realised in both teaching and research.

A Smart, Successful Scotland correctly raised the profile of global connections, and arguably the overall challenge facing us in this region (as in many other rural areas) is to adapt to rapid change, to be ever more outward looking in our approach and to build the role of the Highlands & Islands in a modern Scotland. It is against this background, therefore, that our response to the Committee’s current review is set.

The Tribal HCH Research
We have reviewed the work undertaken by Peter Wood of Tribal HCH and believe it is an important contribution to understanding both the scale and distribution of public spending in Scotland aimed at stimulating economic development. The research correctly focuses on establishing a baseline and setting out the definitions and assumptions involved in compiling it, stopping short of relating the findings to wider issues of rationale and effectiveness. These latter issues are clearly of fundamental significance and are thus picked up in the five areas of interest identified by the Committee’s invitation to submit evidence.

Five Key Questions – the HIE Network’s Views
Do you think the overall level and growth of what the research terms “primary spending” on economic development has been appropriate?

In terms of the Highlands & Islands, the answer is a qualified ‘yes’. Looking at the levels of primary spending over the period considered by the research, it would be fair to conclude that few, if any, valuable economic development opportunities have been lost to the area. On the other hand, the economic development process is always a combination of responding to business proposals and spending proactively (and sometimes opportunistically) to create conditions/infrastructure for growth. The latter is at most times capable of being accelerated and to that extent increased resources – perhaps in the range up to 25% above actual spending – could have been deployed to bring forward or enhance projects and initiatives. However, there is the real consideration of absorbency, since a rural region like the Highlands & Islands can plan, fund and execute a finite number of these during a given time period.

The progress of the EU-funded Highlands & Islands Special Transitional Programme since 2000 illustrates the point. While the commitment and drawdown of funds are likely to ensure full Programme expenditure by its completion, the Programme Monitoring Committee has continually reviewed a pattern of applications which reflects project planning and match funding difficulties for public sector partners, especially in certain Measures within the Programme. Transport infrastructure is a good example, with spending currently behind profile, despite an identified list of key strategic projects and, beyond that, a much wider set of transport needs across the area which would take many years to address.

To what degree do you think economic development considerations and priorities are reflected in decisions concerning the level and nature of “support spending” (eg expenditure on transport and higher and further education)?
In our view, there is a long-standing implicit understanding in Scotland (and certainly in the Highlands & Islands) of the importance of a wide range of support spending to the economic development process. Discussions on the area’s transport requirements, for example, have been a regular feature at the Convention of the Highlands & Islands since its inception, with housing and water supply/sewerage issues also featuring increasingly. The case for the University of the Highlands & Islands itself has always been advanced on economic development grounds as much as on higher education ones.

Peter Wood’s research does clearly identify the considerable importance of the impact of support spending on economic development in Scotland and, in our view, there is a need for economic development considerations to feature more explicitly in major investment decisions. At the basic level, this should consist of simple economic impact assessment looking at multiplier effects, etc. Beyond that, there is also a case for considering respective impacts at regional and national levels – the former is of especial interest to the HIE Network, where long-term infrastructural deficiencies remain to be addressed and per capita costs of investment are inevitably high. Indeed, one of the strategic issues which needs to be built into such assessment is the extent to which nationally-set standards and practices ought to be viewed more flexibly in remoter, rural areas.

Do you believe that the economic development impact of spending on items such as higher education and public transport has been adequately assessed – for example in the appraisal of such projects?

In some instances, it has, but as our above response states, there is a need to ensure that economic development impact assessment becomes a normal and explicit part of the investment appraisal process, at least for major projects and initiatives in the support spending areas. Part of such assessment should focus on geographical impact, particularly in areas like the Highlands & Islands, where an integrated approach to infrastructure investment is vital. Public-sector capital expenditure (including EU Structural Funds) in the Western Isles over the last ten years, for example, illustrates how synergy between projects can be obtained and long-term generative effects achieved for the local economy.

What is your opinion of the available evidence on the output and impact of the budgets of Scottish Enterprise and Highlands & Islands Enterprise and of the scale of those outputs and impacts?

In responding as objectively as possible to this question, we would wish to make a number of key points only at this stage, although we would be happy subsequently to respond to any matters of detail which the Committee might wish to raise.

First, as summarised earlier, economic development efforts in the Highlands & Islands have been proceeding in a concerted way since the establishment of the HIDB in 1965 (although previous interventions stretch back into the late-19th century). As a result, there is very good evidence available on the economic development experience of the area over a long period. That evidence illustrates a fundamental turnaround in the economic and social fortunes of the Highlands & Islands. There are many independent commentaries on how that turnaround has
been achieved, but the major explanatory factors are covered in the section on A Generation of Progress earlier in this submission. We believe it is a widely-held view that the HIDB/HIE economic development agency model has worked very effectively, while recognising that other factors moved favourably over the same period.

Secondly, the activities undertaken by the HIE Network have evolved steadily over time and there is a large body of measurement information available on the performance of both current and past programmes and initiatives. Internally, the Network has a schedule of evaluations which allows conclusions to be drawn on the cost-effectiveness of its interventions, allowing new or re-focussed activity to be guided by the lessons of previous work.

Thirdly, the HIE Network is guided in its efforts by a long-standing approach (outlined in A Smart, Successful Scotland – the Highlands & Islands Dimension) to tackling differences in prosperity within the area. Thus, allocation of Network resources is targeted towards those parts where the traditional symptoms of economic decline persist. In the last year or so, for example, the Western Isles have attracted over 20% of the Network's budget despite accounting for only around 8% of the Highlands & Islands population. This reflects both the importance we attach to tackling the economic challenges facing the islands, but also a belief in the ability of long-term, focussed investment to stem population loss and raise income levels.

Finally, in supporting the refreshment of A Smart, Successful Scotland, we clearly wish to endorse its central principle that building sustainable economic progress at the national and regional levels requires a combination of sustained actions across several broad fronts. The Joint Performance Team’s work over the last three years to produce an annual measurement report, charting progress against the priorities of A Smart, Successful, has illustrated that measurement of economic development necessarily involves a large number of individual indicators – some of which reflect short-term progress (eg digital connectivity) and others much longer-term effort (eg greater entrepreneurial dynamism). We believe that the available evidence on the outputs and impacts of the Enterprise Networks is comprehensive and detailed. Our plea to the Committee is that the Review should recognise that achieving A Smart, Successful Scotland will require strategic continuity and sustained commitment of effort if long-term improvement in the performance of the economy is to be achieved. Do you think the balance of expenditure between primary and support spending has matched economic development needs and priorities?

This is a difficult question to answer within a Highlands & Islands context, since it is difficult to envisage how a change in the balance of primary and support spending might have been deployed. Our view is that any small increase in primary spending at the expense of support spending would have been more helpful than the other way round, but the issue of absorbency which we touched on previously would also have been an important factor. However, had the resources available for primary spending been significantly higher, then a step-change in the way in which the HIE Network implemented A Smart, Successful Scotland would have had to be considered. This would have raised the possibility of forms of intervention not
currently used, notably those involving major capital investment in new settlements, new business infrastructure, new technologies, etc.

Within the existing level of resources, the HIE Network is currently re-balancing its effort more towards major projects which will make a long-term impact on the success of the area. The current range of opportunities is unprecedented and we believe that there are currently a number of initiatives and projects in the Highlands & Islands which are significant at a Scottish level. These include the development of the renewable energy sector; the decommissioning of Dounreay; the innovative roll-out of broadband capacity (and its application) in remote areas; the establishment of a University of the Highlands & Islands; the marine science centre of excellence at Dunstaffnage; the prospective creation of a Gaelic digital television channel; and the expansion of the social economy and community ownership models. In our view, these represent opportunities for Scotland as a whole and not just for their respective host communities.

**Concluding Thoughts**

We recognise that the research undertaken by Tribal HCH raises a range of issues around the way in which public-sector spending in Scotland seeks to stimulate economic development. The Highlands & Islands Enterprise Network is a niche player in terms of the level of our expenditure, but we believe that there are important lessons to be learned from the economic performance of our area over recent decades. Two important ones are worth underling by way of conclusion. First, a growing economy is better able to generate the human and tax base to allow for the enhanced provision of wider public services such as education and healthcare. Secondly, population growth and economic growth are inextricably linked and the continuation of progress in the Highlands & Islands in the coming years will depend on our ability to create the conditions for population growth in all parts of the area.

**SUBMISSION FROM SCOTTISH ENTERPRISE**

**Introduction**

1. The Scottish Executive’s Partnership Agreement in 2003 is clear: “Growing the economy is our top priority. A successful economy is key to our future prosperity and a pre-requisite for building first class public services, social justice and a Scotland of opportunity”

2. Scottish Enterprise (SE), alongside Highlands and Islands Enterprise (HIE), is the main public agency for stimulating investment in the Scottish economy in pursuit of this priority. However, we are only directly responsible for a relatively small proportion of the investment in the economy each year. Our role is essentially catalytic, with the aim of stimulating more, better or faster investment than would otherwise take place to realise Scotland’s full potential. There are many dependencies involved in promoting economic development and success requires an effective investment alliance across the public, private and voluntary sectors.

3. We are guided in our task by the Ministerial ambitions set out in A Smart Successful Scotland (SSS). Over the longer term, our aim is to help Scotland
become one of the best performing economies in the OECD. To achieve this will require:

- a strong, growing business base which is innovative and successful on an international stage
- dynamic and growing industries – both existing and emerging, such as energy and life sciences
- vibrant, well connected city regions which will be the hubs around which wealth is generated
- a skilled and talented workforce drawn from those that are educated in Scotland and those that choose to come and live and work here.

4. Our response to the Committee’s request for evidence reflects the serious budgetary issues we feel should be addressed if the Executive’s ambitions for the economy are to be realised. We recognise the difficulty in reconciling competing priorities in public spending. Given these difficulties we think it is important that public expenditure on economic development is seen as an investment which, in addition to improving living standards directly will help generate the wherewithal to meet spending priorities elsewhere in the Government’s programme, through increasing the tax base and generating additional revenues.

Summary
5. We feel that there is a strong case to be made for greater public resources to be invested in stimulating additional economic development in Scotland. There are three main elements to this case. We would argue that current investment is low relative to:

- the economic challenge Scotland faces - despite significant achievements as a result of past investment - not least in coping with major economic restructuring - on many of the lead indicators in the SSS measurement framework the Scottish economy is only in the third quartile of OECD economies.

Not only is there a gap in current performance to be bridged, but the rest of the world is not standing still. There is therefore a real urgency to make the most of Scotland’s undoubted economic potential in this unforgiving environment.

- past investment - Peter Wood’s review highlights the significant real decline in public investment in economic development in Scotland over recent years. Although public investment is not confined to SE’s budget alone, this provides a good example - we estimate that if the SE budget had kept pace with inflation and the level of public spending in Scotland since it was established in 1991, it would now be around 90% higher than its current level.
• investment in other areas – it is difficult to do like for like comparisons with other places, but it is our strong impression that other countries and regions have been increasing or at least maintaining their investment in economic development as Scotland’s investment has declined, for example, the emergence of the English RDAs and the attention being given to strategic physical regeneration in England.

6. As well as greater investment there is also a strong case for better investment. In the main this means making more of the potential synergies and dependencies between different activities, for example, business development, further and higher education, infrastructure provision and planning. This will require a stronger investment alliance across the public sector to both stimulate and support private investment. To be effective this alliance must be guided by a shared clarity of purpose and strategy. The refreshed Framework for Economic Development in Scotland and SSS, provide the foundation on which such an alliance can be built.

7. The remainder of this response to the Committee’s inquiry is structured around the questions posed by the Convener in his letter of 28 June 2004.

Do you think the overall level and growth of what the research terms ‘primary spending’ on economic development has been appropriate?

8. The SSS measurement framework shows the scale of the task in context against which spending levels can be judged. Although significant progress has undoubtedly been made in restructuring the economy at a time of major industrial change, much remains to be done. The chart overleaf shows that against a series of indicators reflecting the priorities of SSS, Scotland performs relatively poorly against OECD comparators. On the overall measure of Gross Domestic Product (GDP) per head we are in the third quartile, as we are for the majority of other indicators and on some, like business R&D (which is only a quarter of the top quartile average) the gap we need to bridge is large. There is no question that Scotland has the potential to succeed, as our best companies demonstrate. The issue is to improve average performance by helping more businesses to perform closer to the levels of the best. This is amply demonstrated in relation to productivity, where on average Scotland’s performance is 20-30% below major competitors, yet within Scotland (and within individual sectors) the performance of the best is five times that of the worst.
Table 1: The relative position of the Scottish economy against OECD countries for a range of indicators.

<table>
<thead>
<tr>
<th>Overall Objective</th>
<th>Standard of Living (GDP/head)</th>
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<tbody>
<tr>
<td>Growing Business</td>
<td>Global Connections</td>
</tr>
<tr>
<td>High growth firms (starts)</td>
<td>Broadband cost/coverage</td>
</tr>
<tr>
<td>Businesses trading online</td>
<td>Companies Exporting</td>
</tr>
<tr>
<td>Business R&amp;D</td>
<td>Graduates in workforce</td>
</tr>
<tr>
<td>Labour productivity</td>
<td>Working age net migration</td>
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9. Whilst recognising the difficulties of definition and categorisation, the findings of the Committee’s research highlight how the relative scale of investment in economic development has fallen. This supports our own analysis which suggests that if SE’s budget had kept in line with the proportion of government expenditure it was at in 1991, it would now be c. £850m e.g. some 90% more than it currently is. We do not think this trend is appropriate given the scale of the challenge faced.

10. We focus resources on what we judge to be the top priorities for achieving the ambitions of a SSS. In essence, identifying those projects that have the greatest potential to contribute to economic development and most need our support to realise this potential. As with all organisations, resource constraints mean that not all aspirations can be met. The scale and speed of our investment in new and growing Scottish companies, the existing and future workforce and the environment for business could have been greater with greater financial resource. This would have led to a greater impact on growth in the Scottish economy than would otherwise have been the case.

11. As well as the amount of investment, we also recognise the need to improve the effectiveness and efficiency of our investment. This is why we embarked upon our ‘Business Transformation’ initiative to reduce our costs and increase productivity, to increase the impact of our activities relative to the inputs. We will continue to strive to make every pound of taxpayers money with which we are entrusted go as far as possible.

12. The review highlights a number of specific issues such as the relatively high proportion of economic development expenditure in rural areas. This is in part a consequence of the costs of providing services in rural areas. It draws attention to the importance of developing a better understanding of the changing nature of Scotland’s economic geography in relation to the wider international economy, and how best public investment should be deployed to stimulate development. We are increasingly convinced of the need to realise the potential of Scotland’s city regions as wealth hubs and the complementary role that can
be played by Scotland’s rural areas. This ties in closely with “Cities Review” and the National Planning Framework for Scotland.

13. The Committee’s research draws out other consequences of the changing nature of economic development. For example, the reduction in ‘demand led’ spending on Regional Selective Assistance (RSA), as a result of falling inward investment activity. It is important that changes in conditions do not automatically lead to reductions in investment when reallocation to meet the changing conditions may be more appropriate. A good example of this was the way in which RSA resources were diverted to help establish the Co-investment Fund which supports venture capital investment in growing businesses.

To what degree do you think economic development considerations and priorities are reflected in decisions concerning the level and nature of ‘support spending’ (e.g. expenditure on transport and higher and further education)?

14. Economic development is an area where there are many dependencies across Government and its agencies. If anything the move towards more knowledge based and more globally mobile activities has exacerbated this. This puts growing demands on the need to effectively join up action to make the most of these links. A good example of this is in Higher and Further education where we are working ever more closely with the Funding Councils to increase the impact of our investment in skills and learning. As a relatively small, well connected country, building effective alliances between investment partners should be one of our competitive advantages - we have to guard against fragmentation of effort. Great improvements have been made in recent years but more could be done. SE can and will do all it can to act as a catalyst to make the most of vital opportunities for joint action in pursuit of economic development.

15. In addition to aligning investment there is also an opportunity to make sure that ‘non spending’ factors such as land use planning and the statutory and regulatory environment play their part in promoting development. Not only could this help promote the development of existing businesses, it will also help make Scotland a more attractive place to do business.

Do you believe that the economic development impact of spending on items such as higher education and public transport has been adequately assessed – for example in the appraisal of such projects?

16. There is evidence that this is increasingly being taken into account in spending decisions, although there is scope to increase this and give it greater priority.

What is your opinion of the available evidence on the output and impact of the budgets of Scottish Enterprise and Highlands and Islands Enterprise and of the scale of these outputs and impacts?

17. As the review notes, estimating the impact of economic development expenditure is challenging. For example, it is difficult to isolate the precise cause of one change in the economy, particularly one that occurs over a long period of time, let alone completely attribute that to any specific public
intervention. However, this is not a reason not to attempt it. We are committed to improving the quality of our impact analysis to improve our understanding of our impact on the economy, so that we can improve our strategy and operations and help demonstrate value for money to our stakeholders.

18. The diagram below charts the link between inputs and eventual impacts. The nearer the bottom of the triangle the easier it is to record reliable data. As you move up the triangle unambiguous attribution becomes harder. There is a danger that this leads to too much attention being focused on the things which can be measured relatively easily and not enough on the end results we really want to achieve.

19. The briefing note in Appendix 1 sets out some of the issues involved in measuring outputs and impact, and SE’s approach to measuring impact in more detail. This approach allows a number of different perspectives on performance to be taken to allow a more rounded performance judgement to be made:

- Benchmarking key indicators (SSS Measurement Framework);
- In year output performance monitoring;
- Evaluation of individual projects and programmes;
- Aggregation of evaluation/output performance evidence;
- Macro economic modelling;
- Customer feedback.

Do you think the balance between primary and support spending has matched development needs and priorities?

20. The balance between primary and support expenditure will vary over time given the nature of what is involved. For example, major infrastructure projects, such
as the M74 extension, will require significant expenditure, but will not necessarily be at a consistent level over time. Where possible support investment should be considered as additional to primary expenditure, not a substitute for it. The issue is not so much the balance between primary and support spending, more it is the relationship between them and the need to make sure that support spending does indeed support economic development goals. This is becoming more important as the complementarity between primary and support activity grows. For example, the importance of the quality of the built environment, diverse cultures, thriving communities and creative people all interact to contribute to an enterprising culture. This further emphasises the need for a more “joined up” investment alliance.

21. The processes for prioritising how resources are used to build on the complementarity between primary and support spending are important. For example, the effort that has gone into building a stronger strategic relationship between the higher and further education funding councils and the enterprise networks is now starting to bear fruit, as is the alignment of local strategic priorities of partners through the Local Economic Forums (LEFs). The more we can move to a greater shared ownership of our economic development strategy and activities the more effective they will be.

Appendix 1 – Measuring the impact of SE

Introduction
This briefing note describes the approach being taken by SE to assess and better understand the impact of our work to help build a Smart Successful Scotland. It also sets out some of the results of this work.
Our approach to measuring impact
Measuring the impact of an economic development agency is a complex task. In recognition of this we have developed several different ways of measuring impact to provide a number of perspectives on this issue. The different approaches include:

- benchmarking key indicators (SSS Measurement Framework);
- in year output performance monitoring;
- evaluation of individual projects and programmes;
- aggregation of evaluation/output performance evidence;
- macro economic modelling; and
- customer feedback.

A complex task
The complexity of the task stems from a number of factors:
Nature of our economic interventions
- The economy is becoming increasingly complex (for example, through more global links, ‘intangible’ activities and changing business relationships). In this environment the consequences of particular actions are sometimes difficult to assess and measure.

- The wide range of activities undertaken by SE, and the nature of the interrelationships between them (business start-ups, innovation, inward investment, physical infrastructure, skills, inclusion etc.)
The increasing focus on actions that will impact on a systemic basis to build a virtuous, self reinforcing cycle of development. Disentangling cause and effect in this environment is difficult.

The growing recognition of the importance of partnership working, which makes it hard to isolate the individual contribution of partners.

**Issues of methodology**
- Difficulties in accurately assessing what would have happen without any intervention.
- Accurately assessing the further, unintended consequences of intervention. For example, some assistance can ‘displace’ activity from elsewhere in the economy. This may be less of an issue for initiatives aimed at improving inclusion in some specific areas, but it is important when trying to assess the overall impact on Scotland.
- Difficulties in capturing accurate and objective estimates of the impact of a particular action through asking those in receipt of support.

These complexities are presented to give an insight into the nature of the task; they do not present an excuse for not trying to get a better understanding of the impact of development agencies. Indeed, these difficulties are experienced by economic development agencies across the world and we try to learn from what others are doing elsewhere.

**Benchmarking Key Indicators**
(SSS Measurement Framework)

When SSS was published a ‘Joint Performance Team’ comprising members from the Scottish Executive, SE and HIE was set up. The first task of this group was to develop a framework for measuring progress towards achieving the objectives of SSS. The measurement framework developed by the team, after widespread consultation, was published in January 2002¹.

The framework identifies twelve lead indicators (and a number of support indicators) against which to measure progress in each of the priorities of Smart Successful Scotland. It also identifies one overall standard of living indicator (GDP per head – currently 3rd quartile OECD). The aspiration is for Scotland to perform on a par with the top quartile of OECD countries in each indicator in the medium to long term. A progress report is published annually. The table below shows the headline indicators and the results from the 2003 report. The 2004 report will be published shortly.

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¹ Measuring Scotland’s progress towards a SSS: Scottish Executive (2002)
In year Output Performance
Over recent years we have developed our in house system to improve the recording and analysis of in-year performance (the Knowledge Management Information System - KMIS). KMIS provides detailed in-year information on the inputs, activities and outputs for individual projects and programmes that can then be aggregated up to measure overall performance. We publish measures of progress and targets in our Operating Plan and report on performance in our Annual Report. The measures of progress for 2004/05 are shown in the table below.

<table>
<thead>
<tr>
<th>SSS theme/priority</th>
<th>Lead Indicator</th>
<th>2003 report position</th>
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<tr>
<td>Growing Business</td>
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<td>Entrepreneurial dynamism</td>
<td>High growth firms</td>
<td>3rd quartile</td>
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<td>e-business</td>
<td>Businesses trading online</td>
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<tr>
<td>Innovation</td>
<td>Business R&amp;D</td>
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<tr>
<td>Key Sectors</td>
<td>Manufacturing productivity</td>
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<tr>
<td>Global Connections</td>
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<tr>
<td>Digital connectivity</td>
<td>Broadband cost/coverage</td>
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<td>Global markets</td>
<td>Companies exporting</td>
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<tr>
<td>Global location</td>
<td>Graduates in workforce</td>
<td>2nd</td>
</tr>
<tr>
<td>Living and working in Scotland</td>
<td>Net migration</td>
<td>4th</td>
</tr>
<tr>
<td>Skills and Learning</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Labour market</td>
<td>Employment rate</td>
<td>2nd</td>
</tr>
<tr>
<td>Young people</td>
<td>16-19 in employment etc.</td>
<td>3rd</td>
</tr>
<tr>
<td>Unemployment gap</td>
<td>Worst 10% areas ratio</td>
<td>3rd</td>
</tr>
<tr>
<td>In work training</td>
<td>% in employment training</td>
<td>3rd</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>04/05 target</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total business start ups we helped</td>
</tr>
<tr>
<td><em>Business starts supported through the services such as the Business Gateway. Businesses have to either have started trading or opened a business bank account</em></td>
</tr>
<tr>
<td>9,000 – 9,900</td>
</tr>
<tr>
<td>- high growth business start ups</td>
</tr>
<tr>
<td><em>Start ups forecast to achieve a turnover of over £750k or have at least 15 employees within three years</em></td>
</tr>
<tr>
<td>140-150</td>
</tr>
<tr>
<td>Account managed businesses improving their business performance</td>
</tr>
<tr>
<td><em>Improvements in performance of the companies against specific growth characteristics tracked against an agreed development plan.</em></td>
</tr>
<tr>
<td>330-350</td>
</tr>
<tr>
<td>Knowledge Transfer supported by the Network</td>
</tr>
<tr>
<td><em>Academic and company spin outs supported, licences acquired by businesses to exploit intellectual property, and the number of new technology based collaborative ventures between universities and</em></td>
</tr>
<tr>
<td>100-110</td>
</tr>
</tbody>
</table>
Organisations helped to do business internationally\(^2\)

Businesses supported to internationalise (new to international activity or supported to further develop internationally). More attention is being focussed on deeper forms of international participation like setting up an international joint venture.

<table>
<thead>
<tr>
<th>Description</th>
<th>Count</th>
</tr>
</thead>
<tbody>
<tr>
<td>Planned high value jobs brought to Scotland through our support for inward investment. Planned jobs through inward investment activities which are either jobs in research, design or development, or jobs which are advertised at 20% above the current Scottish average salary (currently above £25k).</td>
<td>950 – 1,050</td>
</tr>
<tr>
<td>Individuals, of working age, benefiting from career planning. Includes career guidance interviews, job search support and career planning.</td>
<td>177,000 – 184,000</td>
</tr>
<tr>
<td>Individuals on occupational training programmes. Includes young people participating in Modern Apprenticeships, Skillseekers and Get Ready for Work and older people participating in adult MAs and Training for Work.</td>
<td>41,000–46,000</td>
</tr>
<tr>
<td>Individuals achieving a positive outcome from occupational training programmes. Includes the achievement of a Modern Apprenticeship etc, moving into full time education or employment. Related to the above target but as some programmes last for more than a year there is not a direct relationship between the two.</td>
<td>14,700 -16,700</td>
</tr>
<tr>
<td>Small to Medium sized companies helped to take steps to develop their workforce. Includes successful first time recognitions of Investors in People, companies engaged in Business Learning Accounts and small and medium size businesses supported to engage in workforce development activities.</td>
<td>2,000 – 2,200</td>
</tr>
</tbody>
</table>

The main drawback is the difficulty of measuring impacts (e.g. increase in value added) from this performance information. This is because although in-year outputs are relatively easy to record, the ultimate impact of an initiative may not be realised until some time well after action is taken.

Project and Programme Evaluation

To attempt to address some of these difficulties, we undertake more in depth evaluation studies. These studies are designed to:

- assess how well a project has worked relative to its original objectives;

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\(^2\) These measures reflect Scottish Development International's all-Scotland remit, including the Highland & Island Enterprise area.
• capture the experience of those involved in the projects;
• identify ways in which future projects can be improved; and
• estimate the impact of the project over a longer period.

To estimate impact in an ideal world, we would go back to each company or organisation we have worked with, measure the impact of these individual interventions and aggregate them. However the number of businesses helped makes this an unrealistic proposition. (Around 20,000 businesses each year alone can be involved in varying ways and to varying degrees with SE). Most evaluation studies involve a sample survey of clients.

The studies aim to estimate the ‘net additional’ impact of SE activities. This takes into account the effects of deadweight (what would have happened anyway) and displacement (activity lost in other parts of the economy as a result of the activity), and thus provides estimates of the ‘additionality’ of interventions. Sample surveys are then grossed up to provide an overall estimate of the impact of a project or program.

We have carried out over 250 evaluations since 1997 and we have an ongoing programme of evaluations. Evaluations range from analyses of small projects delivered by Local Enterprise Companies to analyses of strategic, network wide programmes.

Aggregating Evaluation/Performance Evidence

Although it is not possible to evaluate every project or programme, evaluation evidence has been used to develop an ‘Evaluation/Impact Model’ (in conjunction with Cambridge Policy Consultants) to estimate the overall impacts of our activities. This involves grouping evaluation evidence by SSS themes and priorities. This evidence is then used to develop a set of parameters which can be used to estimate the impacts resulting from various types of activity and outputs. For example, business growth evaluations were examined to calculate the average impact (in terms of jobs created or value added) per business assist, and inclusion evaluations were examined to estimate the average number of jobs created or redistributed per programme trainee.

These estimates can then be used to estimate the impact of activities in any one year. Applying this methodology to 2001/02 gave estimates of over 15,000 net additional jobs (after allowing for displacement etc) generated during the three years after the activity and almost £240M added to GDP.

The main advantage of this approach is that it uses evidence taken from a large number of independent evaluations, along with up-to-date performance information. However, there are a number of disadvantages. Given that the approach is based on evaluation evidence, the model is dependent on the quality of the original evaluations. For example, it is important that evaluations of similar types of activities treat the concepts of displacement and deadweight in a consistent manner. We are addressing this by providing training and guidance to those undertaking evaluation work.

To be robust, this approach also requires a good spread of evaluation evidence across different types of activity. In some cases, evidence may be based on just one or two evaluations. Where this happens, the model uses evaluation evidence from
outside the network, or relies on evaluation evidence from other similar types of activity.

Despite its drawbacks this is an innovative approach to impact assessment (no other organisation which operates on the scale of SE appears to have followed this type of methodology) which adds to the overall understanding of the impact of our activities.

Macro Economic Modelling
Although individual programmes of SE activity are targeted on achieving specific objectives, they also generate indirect effects, or ‘spin-off’ benefits to the wider economy. Individual evaluation studies usually include some estimate of these indirect impacts, but the main drawback is that the ‘multipliers’ used to measure them don’t necessarily capture all of the wider impact on the economy, such as that generated by:

- increased demand from increased investment;
- improved linkages between firms;
- supply-side effects on productivity and their impact on consumption.

To address the difficulty of measuring wider impacts, we have worked with Fraser of Allander Institute (FoA), using their model of the Scottish economy. This approach was used in 2000 to estimate the impacts of SE activity in 1997/8. Evaluation results, based on a 1998 version of the Evaluation Impact Model outlined above, were input to the FoA model which provided an overall (direct and indirect) estimation of impacts. This exercise suggested that SE’s 1997/8 programme of work generated 33,100 jobs in Scotland (22,700 direct and 10,400 indirect jobs). This highlights the magnitude of the indirect or spin-off impacts of SE’s activities when compared to the evaluation aggregation approach.

Even this approach may not capture all of the impact, as it focuses on a limited number of variables in order to simplify the analysis. For example, it focuses primarily on variables measuring changes in economic activity (employment and GDP) and did not consider other impacts from activities (particularly relating to social inclusion, skills and environmental improvements). It also does not pick up some of the potential benefits from inward investment, such as new technology or management/skills transfers, so even this analysis may have underestimated the overall impacts of our activities.

Customer Feedback
We have also instituted a more rigorous approach to gathering customer intelligence and feedback. This helps us better understand the issues and competitive pressures facing customers, but it also provides us with almost ‘real-time’ feedback about how we are treating and assisting our customers. Sources of intelligence include business forums, focus groups, customer satisfaction research, comments and complaints from customers (e.g. through the Network Helpline and Website) and feedback from the biggest 100 companies in Scotland.

These provide information on the standards of SE’s activities as well as feedback on the issues facing clients, which in turn feed into policy and programme development.

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3 The Impact of SE Policies on the economies of Scotland and the rest of the UK: Fraser of Allander Institute, Quarterly Economic Commentary, Volume 25 No. 1, (2000)
Conclusions
The precise impacts of the work of an economic development agency are difficult to determine unambiguously. However, we are committed to better understanding the impact of our work, both to demonstrate value for public money and to learn the lessons of experience to help us improve future performance.

This paper has outlined the various approaches we are developing to give as robust estimates of impact as possible. On the basis of the work to date we estimate from our analysis of recent years that our annual activities help generate in the order of 20,000 and 25,000 jobs over a three year period in Scotland that would not otherwise have existed. This would imply an additional £600M - £750M a year in value added in Scotland by the end of the third year.

The relatively short-term employment impact of our work is only one, albeit extremely important, part of the picture. We are also trying to help build a strong, sustainable Scottish economy over the longer term through structural improvements in factors that drive economic performance like investment in innovation.

SUBMISSION FROM COMMUNITIES SCOTLAND

This paper relates to the Finance Committee’s cross cutting review of economic development. It sets out the contribution that Communities Scotland makes to economic development in Scotland. In keeping with the status of Communities Scotland as an agency of the Scottish Executive it presents factual information on Communities Scotland’s role.

Communities Scotland was established in November 2001 as the national housing and regeneration agency. Our primary focus is regenerating the most disadvantaged communities, encompassing both physical regeneration and closing the opportunity gap for those who live in those communities. In carrying out these functions we seek opportunities to connect our work in a way that supports Ministers’ objective of supporting economic growth. This paper provides examples of Communities Scotland’s activities that support economic development through the setting of corporate priorities, close working with other agencies to ensure alignment of priorities and investment, and direct support for individual projects.

Priorities
There are three ways in which Communities Scotland helps to deliver better housing and to regenerate disadvantaged communities:

We manage targeted investment programmes to tackle poverty, regenerate communities and improve the quality of housing. Examples being: the Affordable Housing Investment Programme to provide new supply and replacement housing; support for Community Ownership; running a range of fuel poverty programmes; the Community Regeneration Fund leading to improved regeneration outcomes for communities; developing the social economy and social economy organisations initially through the Futurebuilders Scotland fund.
We work with a range of organisations to raise standards in the delivery of services and in the regeneration of disadvantaged neighbourhoods. Examples being: our work to regulate and inspect social landlords, leading to improved services to tenants; ensuring delivery of the Scottish Housing Quality Standard to improve physical standards in social housing; encouraging improved housing quality and sustainability.

We improve the understanding of the problems experienced by disadvantaged communities and the best ways to tackle them. Examples being: to encourage the adoption of good practice and innovation in regeneration through the activities of the Scottish Centre for Regeneration; support good practice in adult literacies and numeracy, and community learning and development; work with local authorities to prepare high quality local housing strategies.

Community Regeneration and Economic Development
Community regeneration aims to make the communities where people live be the places where they want to live. We recognise that this needs more than just physical change within a neighbourhood but also support for people to improve their quality of life. We also recognise that the main way of achieving this is through helping people within disadvantaged communities to gain the confidence and skills to get a job and progress within a job. We also recognise that to do this Communities Scotland needs to work with other agencies and organisations, and in particular Scottish Enterprise and Highlands and Islands Enterprise. It should also be borne in mind that although CS manages a range of funding streams the delivery of these on the ground is often undertaken by locally based organisations such as Social Inclusion Partnerships, Community Planning Partnerships and housing associations.

Investment in Physical Regeneration
The most direct and apparent activity which impacts on economic development is the Agency’s housing investment programme. As part of the Communities Portfolio Spending Review outcome, Communities Scotland has been set a target of approving the construction of 21,500 affordable houses over the period 2005-08. Funding of nearly £1.2 billion over the period has been identified by Ministers, to which a further £500 million of private finance is expected to be levered in. This is a significantly increased programme, which will see the affordable housing output in 2007/08 increase to 8,000 approvals, against 5,350 approvals in the current year.

Clearly this scale of activity will generate significant economic benefits in itself, and given the regeneration of focus of so much of the housing investment programme, a high level of activity will take place in some of the most deprived communities. An essential feature of the planning of our investment programme is the work of our area teams in ensuring that this investment meshes with the activities of our partners at the local level, for example by tying it in with wider regeneration efforts or supporting local or neighbouring economic growth initiatives. It is also worth noting that the investment programme offers opportunities for housing associations to run a range of spin-off activities such as offering work placements and undertaking wider environmental programmes.
Closing the Opportunity Gap and Economic Growth

However, important though investment in physical regeneration is, it is clear that we cannot look at social inclusion and economic growth in isolation. With increasing levels of employment there is an opportunity to provide routes into learning, training for jobs and jobs for all. It presents the chance to link people of working age who are jobless or working in low skilled, low wage employment into employment. And tackling this economic inactivity can help to improve the economic potential and performance of an area. The Employability Framework currently being developed by the Scottish Executive will provide a basis for this.

From April 2005 a new Community Regeneration Fund (CRF) - which will be routed through the Community Planning Partnerships (CPPs) – will be established. Community Planning aims to ensure that investments are co-ordinated between agencies, address local needs and help put local people at the heart of the regeneration process.

The CRF - which comprises £318 Million over 3 years - will move the focus from a project-based approach to a more strategic approach to tackling Ministers’ priorities of improving the education, health and job prospects of Scotland’s most deprived communities. The CRF has been allocated to the most deprived 15 per cent of areas using the Scottish Index of Multiple Deprivation 2004. CPPs are now preparing three-year Regeneration Outcome Agreements (ROAs) to provide the strategic and operational framework for the ongoing planning and delivery of services to achieve better and additional outcomes for disadvantaged communities.

Underpinning this will be the need to link opportunity with need through specific actions. These may include better linking major employment generating developments with disadvantaged areas and groups through support, training, childcare, job placement services and aftercare or working collectively to invest in infrastructure to create opportunities.

Linkages with the Enterprise Networks

Communities Scotland was closely involved in the refresh of Smart Successful Scotland and fully supports the focus on economic growth in a way that supports the closing the opportunity gap objectives and targets. The inclusion of Scotland’s most disadvantaged groups and communities is both a social and an economic imperative and Communities Scotland is working with Scottish Enterprise and Highlands and Islands Enterprise to clarify and set out our respective roles. At the local level, there has been and continues to be close working at the project level.

The Social Economy

Communities Scotland has responsibility for promoting the development of the social economy sector in Scotland. Social economy organisations are making a significant contribution to economic development. They employ over 80,000 people and generate around £1 billion a year through providing services. In terms of economic development, they have a particular role to play in giving people not in regular or full-time work a chance to gain skills and experience, opening up possibilities of further employment.
Adult Literacy and Numeracy
Communities Scotland also has a responsibility to develop adult literacy and numeracy approaches in Scotland. We work to support the Adult literacy and numeracy partnerships in the delivery of new literacy learner targets. An example of projects looking to improve access to employment through improving adult literacy and numeracy is the Big Plus and the Big Plus for Business. These are campaigns to raise awareness of the difficulties that can result from a lack of confidence in literacy and numeracy, and to help and encourage employers to support staff with literacy and numeracy problems.

Conclusion
This paper has set out the links between community regeneration functions and economic development and how Communities Scotland contributes to economic development in Scotland. It outlines how we contribute in terms of:

- community regeneration;
- developing the social economy and social economy organisations;
- housing investment, as part of an integrated approach to regeneration;
- improving adult literacy and numeracy; and
- improving the understanding of the links between economic growth and social inclusion

We would be happy to expand on any of the issues discussed and/or provide further examples of our work aimed at improving access to employment for disadvantaged communities and groups.
Finance Committee

31st Meeting 2004 – Tuesday 30 November 2004

Budget Process 2005-06 - SCPA Report on Audit Scotland’s Spending Proposals

1. The Finance Committee has overall responsibility for scrutinising all expenditure paid out of the Scottish Consolidated Fund. In addition to scrutinising the Executive’s Draft Budget, the Committee also scrutinises the budget of the Scottish Parliamentary Corporate Body (SPCB) which is top-sliced from the Scottish Consolidated Fund (ie, the money for this is allocated before the Executive makes its allocations).

2. The other body whose budget is top-sliced is Audit Scotland. However, their spending plans are not directly scrutinised by the Finance Committee. The Public Finance and Accountability (Scotland) Act 2000 (the “PFA Act”) set up the Scottish Commission for Public Audit (SCPA) to scrutinise the spending plans of Audit Scotland. Under the terms of Section 11(9) of the PFA act, Audit Scotland must:

“for each financial year, prepare proposals for its use of resources and expenditure and send the proposals to the Scottish Commission for Public Audit...which is to examine the proposals and report to the Parliament on them”.

3. The SCPA’s membership is cross-party and is approved by Parliament. Each year, the SCPA receives Audit Scotland’s spending plans, takes evidence from the Auditor General and Audit Scotland on them and produces a report on the plans. In effect, the SCPA is giving its views on the whether Audit Scotland’s spending plans should be approved or not. This report must be laid before Parliament.

4. A custom has emerged whereby, as well as laying the report, the SCPA forwards a copy of its report to the Finance Committee and the Finance Committee includes a copy of this report in an annexe to its stage 2 budget report. In this way, the Committee is not directly scrutinising Audit Scotland’s Spending Plans but is considering the SCPA’s scrutiny and taking account of it in its report.

5. The Finance Committee debates its report in Parliament and this is followed by a vote. As the SCPA’s report is annexed to the Finance Committee’s report, then in effect, Parliament is approving Audit Scotland’s proposals through this route. It should be noted that Audit Scotland’s budget does appear in the subsequent Budget Bill which is voted on in its entirety by the Parliament.

6. There is currently a written agreement between the Finance Committee and the SCPA. It is suggested that this should be revised to formalise the custom and practice which has emerged. There are also written
agreements between the Committee and the Executive on the budget process. These will need to be revised to reflect likely changes to the process and this could impact on the agreement between the Committee and the SCPA. Therefore, it would seem sensible for all agreements to be revised at the same time.

7. The revised agreement will address the following issues:

- Recognising the Finance Committee’s responsibility to scrutinise all spending proposals
- Recognising the primacy of the SCPA in scrutinising Audit Scotland’s proposals;
- Creating a formal link between the SCPA’s report and the Finance Committee’s Stage 2 report which takes into account these distinct roles.
- Encouraging the Convener of the SCPA to attend the Finance Committee meetings when it is discussing the SCPA’s report
- Setting out a mechanism which will apply in situations where the SCPA is not content with Audit Scotland’s expenditure proposals.

8. This agreement will be presented to both the Finance Committee and the SCPA for approval. However, this guidance has been produced as it was not possible to have the new agreement drafted and agreed in time for this year’s SCPA report.

Susan Duffy
Clerk to the Committee
Dear Des

SCOTTISH COMMISSION FOR PUBLIC AUDIT: REPORT ON AUDIT SCOTLAND’S EXPENDITURE PROPOSALS 2005-06

The Commission reported to the Parliament on 26 November 2004 on Audit Scotland’s expenditure proposals for 2005-06. I enclose a copy of this report for your information.

You will see from the report that the Commission has criticised Audit Scotland for once again sending its expenditure proposals to the Commission at a later date than that stated in the agreement between the Commission and the Finance Committee (SP Paper 157).

The agreement also states that the Commission is then to send Audit Scotland’s proposals to the Finance Committee and the Scottish Executive by an agreed date, which we are not always able to meet. I would therefore be grateful if you could clarify whether this delay causes any problems for the Finance Committee in its scrutiny of the draft budget. I understand that the Finance Committee and the Scottish Executive will be reviewing the wider budget agreement documents shortly, so perhaps this matter could be considered at that time. I have also written to the Minister for Finance and Public Service Reform on this issue.

On a separate note, the Commission has asked the Minister for clarification on why the Draft Budget 2005-06 combines Audit Scotland’s spending plans with the Scottish Parliament’s. As we note in our report, we believe that these figures should be clearly distinguished, given that they are two separate bodies.

Yours sincerely,
The Scottish Commission for Public Audit

1st Report 2004

Audit Scotland’s Expenditure Proposals 2005-2006

Presented to the Scottish Parliament and published pursuant to section 11(9) of the Public Finance and Accountability (Scotland) Act 2000

26 November 2004
Membership:
Margaret Jamieson (Convener)
Brian Monteith
Cathy Peattie
Keith Raffan
Andrew Welsh

Secretary to the Commission:
Terry Shevlin

Assistant Secretary to the Commission:
Clare O’Neill

Audit Adviser:
Andy Munro
Scottish Commission for Public Audit

1st Report, 2004 (Session 2)


The Commission reports to the Parliament as follows—

1. In terms of section 11(9) of the Public Finance and Accountability (Scotland) Act 2000, the Scottish Commission for Public Audit ("the Commission") must examine Audit Scotland’s proposals for its use of resources and expenditure for each financial year, and report on them to the Parliament.

2. The Commission received a copy of Audit Scotland’s expenditure proposals for the 2005/06 financial year on 14 September 2004. The Commission subsequently met on 2 November 2004 to take evidence on the budget proposals from Mr Robert Black, Auditor General for Scotland; Mr Russell Frith, Director of Audit Strategy, Audit Scotland; and Ms Diane McGiffen, Director of Corporate Services, Audit Scotland. The Commission requested additional written information from Audit Scotland, which was provided by the Auditor General on 10 November 2004. We thank Audit Scotland for its cooperation in providing evidence to us.

3. In addition to detailing its expenditure requirements, Audit Scotland’s submission provided information on its proposal for the Autumn Budget Revision¹, including how it will use end year flexibility funding.

2005/06 Budget Proposals

4. Audit Scotland’s Total Net Expenditure for 2005-06 is £24,041,000. Its estimated income from charges to audited bodies is £18,009,000. The total resource requirements (expenditure which is payable out of the Scottish Consolidated Fund) are £6,525,000: a net operating cost of £6,032,000 and capital of £493,000. (Table 1 in annexe 1 provides more detail on Audit Scotland’s resource requirements.)

5. While the total resource requirements represent a decrease of £580,000 (or 8%) from last year’s submission, once capital costs are removed from both years, the resource requirement represents an increase of £232,000 (or 4%) in revenue funding from last year.

¹ The Budget (Scotland) Act 2004 Amendment (No. 2) Order 2004.
6. The Commission’s questioning focussed on Audit Scotland’s running costs (as detailed in annexe 2 of Audit Scotland’s submission), as we are concerned that there are a number of items where running costs have increased substantially from last year. For example, recruitment and other staff costs have risen by 114%, consultancy costs by 38%, office expenses by 20% and Accounts Commission costs by 21%. In addition, total employee costs and approved auditors have both risen by more than 10%.

7. Audit Scotland explained that it is difficult to make accurate comparisons with the previous year, because VAT is now being applied to audit fees. Once the impact of VAT is taken into account, Audit Scotland claims that the increased costs for approved auditors, consultancy and office expenses (other than employee costs) are not that great. We return to the issue of VAT in paragraph 14 of this report.

8. Audit Scotland acknowledged that there have been increases in staff costs but that these are a consequence of the restructuring of the organisation. For example, it is modernising the audit approach which needs different skills and experiences from people in the post.

9. The Commission believes that the costs associated with restructuring the organisation should now be stabilising. We note the increased budget for the Auditor General for Scotland, but draw to the Parliament’s attention that it is for the Scottish Parliamentary Corporate Body to determine the terms and conditions for the Auditor General.

10. The Auditor General expressed his confidence that, in general, audit activity is delivering tangible benefits, which are being reported in Audit Scotland’s annual reports. For example, previous Audit Scotland reports have identified that £6 million could be saved through improvements to hospital catering and that £14 million could potentially be saved through better prescribing by GPs.

11. The Commission notes the substantial sums that Audit Scotland plans to spend on staff training to develop the new audit methodology. We welcome the principle that improved audit activity should deliver improvements in audit output, and look forward to continuing to receive evidence from Audit Scotland that this is actually being delivered. In order to monitor progress in securing efficiencies, the Commission has agreed with Audit Scotland that, in future years, it will discuss its annual report at the same time as it takes evidence on the expenditure proposals. We also trust that modernising the audit approach will not place undue burdens on public bodies, and that the new approach will be flexible enough to identify existing efficiencies and inefficiencies.

12. Apart from the improvements to the audit approach, the other significant changes in the volume of annual audit activity will be the reduction in NHS audit arising from the abolition of NHS Trusts and the roll out of Best Value audits in local government.

13. We share Audit Scotland’s aspiration that Best Value should be a significant incentive for improvement for local government. We also welcome Audit Scotland’s assessment that the cost of implementing Best Value in Scotland will
compare favourably with England and Wales, and its statement that it does not want any extra resources on a recurrent basis to carry out best value in the rest of the public sector.

14. The Commission would also like to place on the record its satisfaction that the question of Audit Scotland’s VAT status has finally been resolved, although this will result in an 8% increase in charges for all audits in November 2004. The issue has been ongoing since the inception of the Commission and has featured prominently in all its previous reports. We are therefore content that future Audit Scotland expenditure proposals will be more transparent and accurate.

**Autumn Budget Revision**

15. In addition to questioning Audit Scotland on its budget proposals, the Commission took evidence on the Autumn budget revision.

16. Audit Scotland’s revenue underspend for financial year 2003-04 is £2,520,000, which represents more than 10% of its total expenditure for that year. The Commission is concerned to see such a level of underspend, which is extremely high.

17. Audit Scotland is seeking to carry the full amount of revenue underspend forward through the budget revision, as well as £238,000 of capital underspend in relation to the refurbishment of its office on 18 George Street. In addition, Audit Scotland is seeking £700,000 through the budget revision to cover its VAT liabilities.

18. As noted, the Commission is pleased that Audit Scotland’s VAT status has been resolved, but was concerned by such a high level of underspend. Audit Scotland explained that there is a lack of synchronicity between its business cycle and the financial year, which will mean that there is always likely to be an underspend for each financial year. The Commission acknowledges this explanation, and that Audit Scotland must never overspend if a qualification of its accounts is to be avoided. However, we are not content with the underspend and are pleased to note Audit Scotland’s assertion that in future years it should not be as great as it is now.

19. In order to avoid any confusion between Audit Scotland’s expenditure proposals and its in-year budget submission, we have asked for the latter to be presented in a separate annexe in future years. We thank Audit Scotland for agreeing to meet this request.

20. Finally, the Commission intends to write to the Scottish Executive to examine the implications of Audit Scotland continually sending its expenditure proposals to the Commission at a later date than that stated in the agreement between the Commission and the Finance Committee. The Commission raised this issue with Audit Scotland once again this year and was surprised by its claim that it is “complying with the Executive’s requirements for the submission of financial information”.

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2 SP Paper 157.
21. The Commission’s letter to the Executive will also ask why, in the Draft Budget 2005-06, Audit Scotland’s spending plans are combined with the Scottish Parliament’s. The Commission believes that these figures should be clearly distinguished, in the interests of accuracy and transparency.

Conclusions

22. We draw the Parliament’s attention to the observations made and recommend that Audit Scotland’s bid for a budget of £6,525,000 for the year 2005/06 should be approved by the Parliament.
### ANNEXE 1

#### Table 1: Summary of Audit Scotland’s resource requirements

<table>
<thead>
<tr>
<th>Summary of resource requirements</th>
<th>2005-06</th>
<th>2004-05</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts and governance</td>
<td>16,698</td>
<td>14,252</td>
</tr>
<tr>
<td>Performance audit</td>
<td>7,010</td>
<td>6,929</td>
</tr>
<tr>
<td>Other</td>
<td>333</td>
<td>186</td>
</tr>
<tr>
<td>VAT</td>
<td>0</td>
<td>336</td>
</tr>
<tr>
<td><strong>Total Net Expenditure</strong></td>
<td>24,041</td>
<td>21,703</td>
</tr>
<tr>
<td>Income from charges to audited bodies</td>
<td>18,009</td>
<td>15,903</td>
</tr>
<tr>
<td><strong>Net Operating Cost</strong></td>
<td>6,032</td>
<td>5,800</td>
</tr>
<tr>
<td>Capital</td>
<td>493</td>
<td>1,305</td>
</tr>
<tr>
<td><strong>TOTAL RESOURCE REQUIREMENTS</strong></td>
<td>6,525</td>
<td>7,105</td>
</tr>
</tbody>
</table>
