Sustainable growth for Scotland

Improving accountability and performance in enterprise and the public sector
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Who would be a politician? MSPs face a challenging number of years following this year’s Scottish Parliament elections. Reductions in public spending, combined with likely rises in unemployment and a squeeze on capital expenditure, mean that political achievement will be measured, to a large extent, by ensuring the delivery of value and effectively managing budgets.

At times like these, an expertise in finance and measurement is truly valued. That is why ICAS has created, for the first time, a pre-election briefing that seeks to offer MSPs our distinctive views on a number of significant areas of devolved responsibility. I hope these ideas can help all political parties to build a better and more sustainable Scotland in the years ahead.

If you would like to discuss any of these views in more detail, please contact me. My colleagues and I would be delighted to hear from you.

Anton Colella  
Chief Executive  
The Institute of Chartered Accountants of Scotland  
February 2011
1 Putting proposed tax reform on a sure footing

Key points:

- Secondary legislation related to the tax reforms contained in the Scotland Bill should be subject to a vote by the Scottish Parliament, ensuring that it falls within the legislative consent process which has been established for the Bill.
- The regulatory impact assessment which accompanies the Scotland Bill should include an assessment of the likely costs of the tax reforms to the Scottish Government, business and individuals.
- We recommend that a statutory definition of a Scottish taxpayer is introduced which will give greater certainty to all.
- Changes to the income tax regime in Scotland must work in tandem with a reformed benefits system.
- The cost to employers, pension providers and charities of implementing changes to their systems arising from the income tax reforms should be kept to a minimum by ensuring that complex procedures are not required to comply with new requirements.

Legislative scrutiny

We welcome the establishment of the Scotland Bill Committee of the Scottish Parliament to scrutinise the Bill, and the fact that the Bill’s progression through the UK Parliament will be subject to the consent of the Scottish Parliament. As an enabling piece of legislation, arrangements for the Bill’s implementation will be dealt with through secondary legislation by the UK Parliament. As this is such a significant issue for Scotland we believe it is vital that any secondary legislation on tax matters, dealing with the practical aspects of implementation, is subject to a vote, by both the Scottish Parliament and the UK Parliament. This should ensure that the tax reforms work for Scotland and do not create unintended consequences for the economy, for business or for Scottish taxpayers. We also recommend that the administrative costs of the proposals which will be borne by the Scottish Government, business and individuals are included within the regulatory impact assessment which accompanies the reforms.

Making it work

A number of significant issues have emerged surrounding the implementation of these tax reforms, in particular the changes to income tax. Critical to the successful implementation of the income tax reforms are:

- The establishment of a workable definition of a Scottish taxpayer, preferably a statutory definition which is unambiguous and will minimise the costs to individuals of compliance.
- A clear plan setting out how the reserved and devolved elements of the income tax system and reserved and devolved elements of the reformed welfare system will interact and operate in a cohesive manner.
- Greater certainty that the commercial payroll software used by employers has the functionality to deal with divergent tax rates and a different treatment for Scottish taxpayers.
- Pension providers will need to prepare for the impact of the income tax reforms on the tax relief available on pension contributions and tax rates on the refund of contributions. In order to minimise the cost to pension providers of implementing the reforms, the requirements placed on them should be as straightforward as possible and communicated as part of the reform process.
- Charities require clarity about how the Scottish rate of income tax will impact on the amount of gift aid they receive from donations made by Scottish taxpayers. Simplicity and certainty will minimise the cost to charities claiming gift aid and any additional costs could be eliminated if a UK-wide rate continued to apply.
2 Supporting a shift in public service delivery

Key points:

- Investment in infrastructure is central to the economic recovery and for long-term sustainable growth
- The Scottish Futures Trust, procurement specialists and project managers must deliver infrastructure projects on time and to the required standard, ensuring from the outset that budgets are realistic and expenditure is monitored effectively
- The Scottish Government has a role to play in achieving cultural change which will bring shared services arrangements and other forms of joint working to fruition
- The Scottish Government should maintain a comprehensive and up to date Shared Services Framework for the Scottish public sector
- Robust business cases for joint working will only be possible if public bodies understand from the outset legal matters and any tax implications arising from proposed arrangements

The Comprehensive Spending Review and the Scottish Budget

Over the period of the Spending Review (2011-2015), UK public sector expenditure is expected to fall in real terms by 11% (Scotland: 10%). In Scotland, administrative and capital budget allocations are expected to fall in real terms by 6.8% and 38% respectively. The Scottish budget includes plans to bolster capital expenditure in 2011-12 by transferring £100 million from the 2010-11 revenue budget. It is customary to set out detailed spending plans over the spending review period; instead the current administration has established a Commission on the Future Delivery of Public Services to develop recommendations on the future of public services in Scotland.

Continuing to maintain infrastructure investment is central to the economic recovery and for long-term sustainable growth. Scotland has had mixed success in delivering capital projects with high profile overspends, and lower profile successes such as the M74 extension which is expected to be complete by June 2011, nearly nine months earlier than originally planned. With public finances as tight as they are, clearly there is no room for overruns and overspends. Therefore, the Scottish Futures Trust, procurement specialists and project managers must deliver public sector infrastructure projects on time and to the required standard, ensuring that budgets are realistic from the outset and are monitored effectively throughout the duration of projects.

Shared services and joint working

Cuts to public sector budgets were anticipated prior to the Comprehensive Spending Review and public bodies had been reviewing their expenditure and activities with this in mind. The shared services agenda, which had lacked momentum prior to the 2010 Comprehensive Spending Review, has been picked up by a number of Scottish local authorities. Plans to share back office functions and to deliver joint frontline services have been announced.

Public bodies and other providers of public services should be pushing this agenda forward. The Scottish Government has a key role to play in creating an environment where innovative joint working models are more than just good ideas. It is vital that public sector plans to work with other organisations are brought to fruition where there is clear potential for efficiency gains and public service improvements. From the outset, participants in joint working arrangements should establish robust governance and performance management arrangements so that the role and responsibilities of each participant is clear, service outcomes are specified and efficiency savings and service improvements can be identified and reported.
Legal and tax matters

There are legal and tax issues which provide significant challenges for joint working arrangements and part of the battle will be identifying and managing these challenges. For example:

- The ability of a public services provider to reclaim VAT on services could have a significant and recurrent impact on the cost of delivering shared services, depending on the specifics of any arrangements. Local authorities are normally able to reclaim VAT incurred from suppliers but this is not the case for other service providers.

- If employees are transferring from one organisation to another under a joint working arrangement, the crystallisation of any liabilities, such as those arising from obligations under TUPE, will need to be indentified and included within the business case.

Additional liabilities arising from proposals for joint working should be included in any assessment of potential savings and cash flow forecasts produced to support business cases for shared services. Shared services and other forms of joint working are inherently complex and a cultural shift is needed to make these arrangements the norm. Being able to overcome these challenges, could pave the way for the transformation of public services in Scotland.

The Scottish Government has a role to play in ensuring that public services providers, and their professional advisors, consider these issues very early in the planning stage. The Scottish Government produced a Shared Services Framework in 2007 and an update of this Framework is now overdue. A comprehensive and well publicised Framework which reflects the current environment is essential to the development of sound business cases for partnership working.
3 Working with the charity sector

Key points:

- The Scottish Government and local government have responsibility to ensure procurement practices contribute to a sustainable charity sector
- Local government could reduce the administrative burden on charities receiving grant funding by standardising arrangements for the award of funding and performance monitoring. The same principles should apply to commercial tendering processes
- OSCR’s recommendation for a review of Scottish charity law during the next Scottish Parliament provides an opportunity for the Scottish Government to review the Charities and Trustee Investment (Scotland) Act 2005
- Government should seek to create an environment where charities are encouraged to work collaboratively or to reorganise where a change in working arrangements could improve outcomes

The charity sector has a vital role to play in Scottish society through delivering public services, supporting individuals and communities and providing employment. Charities also have considerable purchasing power making them major players in Scotland’s economy. Both the Scottish Government and local government have a role to play in minimising burdens on charities in respect of regulation, funding and procurement practices. They can also enable charities to reorganise where this is the best way to achieve their objectives.

Funding and procurement practices

One consequence of the Comprehensive Spending Review may be that the risks associated with reductions in government budgets are effectively transferred to the charity sector, accompanied by new conditions and performance measures. A long-term view of government’s relationship with charities either as a funder or as a procurer of services is required to ensure that the sector continues to play a significant role in civil society and in the economic recovery.

Calls from the sector for government to pay the full cost of services purchased from charities have not been reflected in government policy. This means that public services are being subsidised by donations. It is questionable whether this is sustainable. Charities have overheads to meet and also need to invest in staff development, IT and bricks and mortar to continue to provide quality services. We believe that the Scottish Government and local government have a responsibility to ensure that their procurement practices contribute to a sustainable charity sector. This includes proper consideration of the financial impact on a charity having to subsidise any shortfall between the actual cost of the public service provided by the charity and the amount of contract income it receives from government.

The Scottish Government’s Concordat with local government means that charities have to negotiate grant funding with each individual local authority they are engaged with rather than by dealing solely with the Scottish Government. As a minimum, it would be helpful if all local authorities awarding grants to charities had consistent arrangements for awarding funding and for performance monitoring, including the reporting of outcomes. Commercial tendering processes, such as tender documents, and performance monitoring arrangements should also be consistent as far as practicable.

Public sector bodies entering into contracts with charities should understand how charities are affected by VAT rules and rules on charitable trading. They should also be able to explain to charities how they are affected by these rules so that charities can make informed decisions about registering for VAT and how to structure their business. It would be beneficial for the charity sector if restrictions on charitable trading were lifted. This is an area where the Scottish Government could seek to influence the UK Government.
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Regulation

In its 2010 annual report, the Office of the Scottish Charity Regulator (OSCR) recommended that the Scottish Government include a review of the Charities and Trustee Investment (Scotland) Act 2005 in its legislative timetable during the period of the next Parliament. We support this recommendation and agree that such a review would allow a comprehensive evaluation of the 2005 Act against initial and current policy objectives and provide an opportunity to consider any new policy objectives. A review would also be an opportunity for broad stakeholder engagement.

Charity reorganisation

There is scope within the Scottish charity sector for mergers to take place. The current economic climate provides incentives to charities to reorganise as a means of increasing their capacity to deliver services and to make savings through reducing overheads. We believe that the Scottish Government and local government have a role to play in encouraging charities to consider new ways of working from the informal to more formal working arrangements and mergers. However, liabilities such as pension liabilities could crystallise as the result of reorganisation and the prospect of this is likely to prevent charities from making major changes to their structures. This could create inertia in the sector. It is important the government understands what barriers to reorganisation exist and seeks to ease them where it can.
4 Creating a stable platform for business

Key points:

- The Scottish Government should work closely with the UK Government to ensure that the private sector led recovery continues and is supported in Scotland
- The Scottish Government should ensure that it utilises its resources effectively to ensure that business start-ups and Small and Medium-sized Enterprises (SMEs) receive the right funding at the right time
- The Scottish Government should ensure that its standard procurement processes are not an added burden on SMEs and that the payment terms for contracts do not disadvantage those businesses which are employed by the main contractor
- The Scottish Government should ensure that full consultation with business is sought for any policy implementation to avoid any unintended consequences that would be counter-productive to the private sector led recovery
- The Scottish Government should be transparent on the reasons for Ministers exercising their current right to “opt-out” of the Business Regulatory Impact Assessment (BRIA) process

We believe that the Scottish Government should work closely with UK Government to ensure that the private sector led recovery continues and is supported in Scotland. We believe this approach will further boost the economy and create jobs, and that it will also ensure that Scottish businesses are not disadvantaged relative to the rest of the UK.

Financing

The capital requirements placed on banks by BASEL III and stricter lending criteria makes access to traditional bank borrowing more difficult for business. The availability of bank lending for businesses is a concern and we encourage the Scottish Government to continue to liaise with the UK Government on this matter.

Angel finance is not always a suitable option for businesses which find themselves unable to access bank finance and other sources of finance, particularly for business start ups and other businesses which service the Scottish market, and can be difficult to secure. We believe that the Scottish Government, through its various funding models, which include the Scottish Co-Investment Fund and the new Scottish Loan Fund, should seek to address the needs of all Scottish businesses to assist in the job creation needed if the private sector led recovery is to be driven forward.

Public sector procurement

It is important that the Scottish Government is aware of the volume of work small businesses are undertaking for the public sector so that the engagement of small business in public sector contracts can be monitored and action taken to increase engagement, if necessary. The Scottish Government has a system which can deliver information on contracts awarded with a value of under £25,000. However, businesses which have been awarded contracts may sub-contract work to other, possibly small, businesses and the Scottish Government has no system for recording this information. We would welcome the extension of existing arrangements to cover sub-contracts.

The Scottish Government’s commitment to pay suppliers’ invoices within ten working days of receipt is a commitment which has not been extended to sub-contractors. We recommend that contracts awarded by the Scottish Government include a requirement for sub-contractors to be paid on terms similar to those given to the main contractor.
Business rates

We welcome the continuation of the Small Business Bonus Scheme, where the rateable value at which no rates will be payable has been increased to £10,000 for 2011-12. However, a further extension of the scheme to cover more businesses would be desirable to support business through the financial crisis and to mitigate the impact of known developments such as difficulties accessing finance, the VAT rise, increases in the minimum wage and the introduction of the auto enrolment of employees into a pension (this will ultimately prove to be a cost for both employees and employers). The auto enrolment of employees into a qualifying pension scheme commences in 2012 and will be phased in for smaller businesses by 2016. Therefore, we recommend that the Scottish Government considers on an annual basis whether existing costs pressures merit the extension of the Small Business Bonus Scheme.

Plans to introduce a business rates supplement of 15p in the pound for Scottish properties valued at more than £750,000, which were subsequently rejected by the Scottish Parliament, could have stifled the expansion plans of some businesses in the coming years. We believe that the Scottish Government should ensure that it does not implement policies that could be counter-productive to the private sector led recovery.

Business Regulatory Impact Assessments

We support the introduction of BRIAs to accompany proposed legislation from 1 April 2010. The Regulatory Review Group (RRG), an independent group established to identify regulations which are hindering the performance of Scottish businesses and to advise the Scottish Government on the broader aspects of better regulation, has identified scope for improving BRIAs. We are represented on the RRG and are supportive of its objectives.

In relation to BRIAs, there is scope to drive through changes which could improve the quality of assessing the estimated cost to business of proposed legislation, such as fuller engagement with the businesses which are most likely to be impacted. We support the ministerial sign off of each BRIA as evidence of a check and balance that due process has been followed on each piece of legislation and regulation, but would welcome greater transparency on the occasions where the relevant Minister has chosen to exercise their right to “opt-out” of the BRIA process.
5 Dealing with debt

Key points:

- The Scottish Government should develop a policy of early intervention aimed at reducing the number of businesses becoming insolvent
- The rules on corporate insolvency, other than receivership, should be reserved to the UK Parliament to promote consistent procedures throughout the UK and the simultaneous introduction of changes to procedures in Scotland
- Proposed regulations which set out procedures for the winding up of a new form of charity, the Scottish Charitable Incorporated Organisation (SCIO), should be subject to further review by the Scottish Government
- We recommend that the Scottish Government reviews its policy towards the responsibility of debtors to repay their creditors and develops a system which incorporates financial education at appropriate levels from school, through to, and during, adulthood
- Homeowners in financial difficulty, creditors, insolvency practitioners and debt advisors must have certainty as to what happens to the proceeds of sale when a family home, which is excluded from the terms of a Trust Deed, is sold during the period of the Trust Deed. We recommend that the Scottish Government develops a policy in this area as a matter of priority
- We fully support the Scottish Government’s Financial Capability Plan, which will provide those in bankruptcy with access to clear information. We recommend that the Financial Capability Plan is extended to also take into account those at risk of bankruptcy – prevention as well as cure

Corporate insolvency

Early intervention
The current high level of corporate insolvencies in Scotland has a detrimental effect on the job market, on the public purse, and on the wider Scottish economy. Company directors and business owners need to be made aware of the benefits of seeking early advice when financial difficulties arise and they must be encouraged to take early action to avoid insolvency.

It is vital that those responsible for running businesses have a sufficient understanding of how to run a business. We recommend that the Scottish Government drives policy development in this area as a matter of priority following the election.

Consistency across the UK
The re-reservation to the UK Parliament of responsibility for corporate winding up procedure, with the exception of receiverships, as proposed in the draft Scotland Bill would be beneficial. Re-reservation would promote consistency throughout the UK, consistency that is lacking under existing arrangements. Re-reservation will mean that any changes can be introduced in Scotland simultaneously with the rest of the UK.

Scottish Charitable Incorporated Organisations (SCIO)
There is an increase in the number of Scottish charities becoming insolvent. It is likely that this trend will continue as the impact of cuts in public expenditure filter through to the charity sector. In 2011, we expect a new form of charity, the Scottish Charitable Incorporated Organisation (SCIO), to become available to the sector under the Charities and Trustee Investment (Scotland) Act 2005. This form of charity will provide charity trustees with limited liability without the need to incorporate as a company limited by guarantee. Legislation which enables SCIOs to be established is to be accompanied by regulations which set out procedures for the solvent and insolvent wind up of SCIOs. We believe that these proposed regulations are insufficiently robust as they do not strike the correct balance between cost and the reality of solvent or insolvent dissolution.
Personal insolvency

Debtors’ responsibility for their debts

Other countries in the EU require debtors to take responsibility for their debts. Scotland appears to be more debtor friendly. This can lead to abuse of bankruptcy laws and regulations. The correct balance has to be achieved between rehabilitation of the debtor and the interests of those who have lost money through bankruptcy.

We recommend that the Scottish Government reviews policy in this area and develops a system which incorporates financial education at appropriate levels from school, through to, and during, adulthood. Once in a bankruptcy process the debtor should be required to meet his or her obligations to his or her creditors, with discharge being conditional on compliance with the responsibilities set out under legislation.

Special criteria should be developed to identify repeat offenders. Where there are indications of abuse of process those debtors should be subject to additional provisions.

The Homeowner and Debtor Protection (Scotland) Act 2010

We have previously expressed concerns to the Scottish Government regarding the treatment of equity in the family home and the potential anomalies arising from the 2010 Act. It is unclear what the policy is if the home, having been excluded from a Trust Deed, is subsequently sold by the debtor during the period of the Trust Deed. Consultation on the topic of the family home is not expected until after the May 2011 Scottish Parliament election. It is vital that homeowners in financial difficulty, creditors, insolvency practitioners and debt advisors have certainty on this issue. We recommend that the Scottish Government addresses this issue as a matter of priority following the election.

The Financial Capability Plan

Scottish Government policy is to provide information for individuals during and after bankruptcy to:

- reduce the stress associated with it;
- help people to have the confidence and knowledge to engage with financial institutions post bankruptcy; and
- help people develop skills to avoid financial trouble in the future.

There is already a great deal of information currently provided by various Scottish Government directorates and non-government organisations. The Financial Capability Plan will bring together existing information which can be developed into a single pack for individuals. We support this project. Additionally, we consider that the Financial Capability Plan should also be targeted towards individuals who have debt problems but who are not yet bankrupt, on the basis that prevention is better than cure.
6 Environmental sustainability

**Key points:**

- Extend the scope of the Carbon Reduction Commitment (CRC) with a simplified measure for smaller businesses and free advice to assist businesses to meet the CRC
- Improve the reach of Zero Waste Scotland to allow smaller businesses to meet their recycling and waste reduction targets
- Introduce environmental sustainability into the school curriculum

The Scottish Government has set some of the toughest environmental targets of any country. While Scotland has much to be proud of – for example being a world leader in the development of renewable energy – some difficult decisions lie ahead. Scotland must become a leader in the field of environmental sustainability while maintaining the long-term competitiveness of the Scottish economy.

**Carbon reduction**

We believe the Scottish Government should consider extending the scope of the Carbon Reduction Commitment (CRC) which currently applies to organisations spending more than £500,000 per annum on electricity. A simplified CRC measure should be applied to organisations spending between £50,000 and £500,000 per annum on electricity – with free advice available on how businesses can meet the CRC.

The Scottish Government should also offer subsidies, graduated to reduce over (say) between ten and fifteen years, to organisations which replace the use of carbon or nuclear based energy with renewable energy sources, including hydro-electricity. This would lead to an increase in demand for renewable energy and should result in increased levels of research into new and improved sources.

**Zero Waste Scotland**

The Scottish Government through Zero Waste Scotland has set ambitious targets for waste and recycling, requiring the collective buy-in of both individuals and business if they are to be achieved. In particular the Scottish Government needs to effectively communicate their policies and provide advice to businesses. With SMEs representing 97% of Scotland’s businesses, it is disappointing to note that since April 2008 only around 246 small businesses have received the free onsite support that is available to help them focus on the opportunities which are available to reduce waste production, packaging, raw material and water use. The Scottish Government needs to be reaching a far higher proportion of Scottish business if their targets are to be attained.

**Education**

Education lies at the heart of a sustainable economy. The Scottish Government should develop and introduce environmental and sustainability studies into the curriculum within the next three years, to raise awareness in school of the risks of insufficient action to protect our environment and the steps which can and should be taken to safeguard the planet’s future.
7 Conclusion

Sustainable growth for Scotland must be the ambition for politicians, the business community and the wider public. This document should contribute fresh thinking about ways in which this goal can be supported.

It is an important time. The public sector in particular faces large cutbacks, new ways of working and increased demand on services. The extension of devolved fiscal responsibility that Scotland will be bequeathed by the Scotland Bill is also a crucial test for the country. It is important for the credibility of Holyrood that the system that is put in place works as it is intended. Harnessing the potential of the voluntary sector should also be an important goal for the next Scottish Government.

At ICAS, the expertise exists to contribute to a better understanding of how these challenges can be addressed. We are open to working with all political parties to build a more sustainable Scotland.