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Convener of the Finance Committee

Sent via email: fpa.committee@parliament.scot

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Dear Convener,

Use of Common Law Powers to Appoint a Chair of the Capital Accounting Review

The Cabinet Secretary for Finance and the Economy provided a commitment, as part of the Resource Spending Review, to a comprehensive review of local authority capital accounting.

The requirement for the review is as a consequence of a two year debate with local government on the accounting treatment for service concession arrangements, which required Scottish Ministers to permit substantial departure from the CIPFA Code of Practice for Local Authority Accounting, which is based on International Financial Reporting Standards.

An independent Chair of the Capital Accounting Review, Michael Hearty, will be appointed, using Common Law powers, in order to ensure that the review is conducted with impartiality and objectivity.

Local Government Directors of Finance were initially asked to take forward this review. In February 2021 the Cabinet Secretary for Finance and the Economy wrote to COSLA setting out the expectations for this review "I would like to see a better alignment with accounting standards as set out in the CIPFA/LASAAC Accounting Code of Practice, with minimal statutory intervention." In the same correspondence Local Government were invited to "bring forward proposals to transition to a position which is less reliant on a statutory underpinning".

The review delivered by Directors of Finance does not represent the comprehensive and holistic review of capital accounting that was requested and argues to maintain existing arrangements without review, rather than providing recommendations to strengthen the capital accounting framework and reduce reliance on statutory intervention. Both Audit Scotland and LASAAC raised concerns with the lack of proactive engagement to develop the review and with the outcome of the review. Audit Scotland noted that "Although the paper is headed A Review of Capital Accounting, it does not appear to consider these accounting issues to any great extent".

Local Government Directors of Finance assert that their Annual Accounts align to the CIPFA Code of Practice for Local Authority Accounting. However, this ignores the fact that statutory mitigations are subsequently applied to those accounts which override the CIPFA Code of Practice for Local Authority Accounting and must therefore be subject to the same disciplined and professional, periodic review as is conducted by accounting standard and accounting code setters to ensure that they remain fit for purpose.

Local Government have suggested that the Capital Accounting Review will result in risks and uncertainty at a time when the financial sustainability of councils is a key concern. This argument is now made despite the flexibilities permitted by the Cabinet Secretary for service concessions having been predicated on the understanding that a comprehensive review of capital accounting would be taken forward.

The statutory intervention permitted for service concessions allows the reversal of costs already incurred (and already passed on to tax payers). Those costs are then reallocated to future years in order to increase immediate spending power (to the detriment of future taxpayers who will again have to meet this cost).

This approach speaks to a lack of prudent financial management, which is compounded by an unwillingness to ensure that capital accounting practices – and the use of statutory intervention – demonstrate prudent financial decision making and remain fit for purpose through a comprehensive review.

Local authorities have openly stated that without current accounting flexibilities, delivered through statutory intervention, which enable them to push the majority of capital investments costs into the future, their capital investment programmes would be unaffordable.

This raises very serious concerns, that must be addressed through the review, as to the prudence and sustainability of local authority financial decision making and demonstrates, quite clearly, that without statutory intervention, capital strategies are unaffordable and unsustainable.

Directors of Finance have also claimed that the outcome of the Capital Accounting Review has been predetermined. The Cabinet Secretary for Finance and the Economy has already provided assurance that there is no predetermined outcome to the review in a letter to COSLA in August 2021 which stated: "I can advise that there is no predetermined outcome from the review but I expect a full consideration of depreciation accounting to form part of that review. Should changes be proposed as a result of the review these will apply prospectively, with transition arrangements ensuring no, or minimal financial impact on existing capital plans."

The independent review will build on the review already taken forward by Directors of Finance, working with key stakeholders to deliver a phased approach towards alignment with the CIPFA Code of Practice for Local Authority Accounting.

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This review will help to enhance the future sustainability of local services and address the inconsistencies of current statutory arrangements with the requirements of the CIPFA Accounting Code.

The ongoing development of the Fiscal Framework for Local Government to deliver greater fiscal empowerment must be underpinned by sustainable financial management with consistent and prudent accounting and financial reporting. An independent review of capital accounting, drawing on the professional expertise of Audit Scotland, CIPFA and LASAAC will complement that work.

Yours sincerely,

Tom Arthur

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