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The budgetary flexibility of Invest Northern Ireland

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This Research Paper presents evidence relevant to the Committee for Enterprise, Trade and Investment's consideration of the case for increased budgetary flexibility for Invest Northern Ireland.

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Key Points

- If Invest Northern Ireland were extended a £15m End-Year Flexibility facility, this would use approximately one quarter of the Northern Ireland Executive's Budget Exchange allowance for resource funding. If it were for capital expenditure, it would use approximately 85% of the Executives allowance;

- Scottish Enterprise is subject to the same requirement as Invest Northern Ireland to manage its budget in year. It does not have an End-Year Flexibility arrangement;

- Scottish Enterprise does, however, have greater in-year flexibility for its management of resources across expenditure categories;

- Invest Northern Ireland is not allowed to retain additional income (receipts) that it generates. This is a different arrangement from that which applies to – at least some - other non-departmental public bodies at the UK level;

- Invest Northern Ireland has a history of success in securing additional funding through the Executive's in-year monitoring process; and,

- The Department of Enterprise, Trade and Investment's performance in financial forecasting appears to show scope for some improvement.

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Introduction

The *Independent Review of Economic Policy* (IREP) published in September 2009 contained some comments on Invest Northern Ireland's (INI) budgetary flexibility. The IREP panel suggested that INI has "*limited budgetary flexibility*".[1] It went on to recommend that:

> *Invest NI should be given greater autonomy in managing its budgets, including End Year Flexibility where required.*[2]

On 18 July 2012, the Minister of Finance replied to a letter from the Chair of the Committee for Enterprise, Trade and Investment (the Committee).[3] In his response, the Minister stated that he believed the current approach to budgetary flexibility for INI should be maintained.

The Minister provided a number of reasons why he believed an extension of INI's budgetary flexibility would be inappropriate:

- Due to the current economic downturn, there is a reluctance/inability for companies to draw on assistance offered and it will therefore be a number of years before INI's actual expenditure catches up with letters of offer;
- The proposal to provide INI with End-Year Flexibility (EYF) would result in substantial unspent resources accumulating and being set aside until the economic conditions improve;
- The Northern Ireland Executive's own EYF is limited and because of the need to focus on strategic priorities it would be indefensible to hand this down to a lower-tier organisation;
- The Northern Ireland Executive operates an in-year monitoring process for expenditure management and redistributes resources throughout the year, unlike in other jurisdictions;
- The ability to accumulate EYF might be seen as a substitute for good financial management; and,
- In the past, bids from INI to support business have been given high priority by the Northern Ireland Executive and there is no reason for this to change in the future.

The purpose of this paper is to examine INI's budgetary flexibility in the context of the Minister's points. The Budget Exchange system (under which the Northern Ireland Executive has some degree of budgetary flexibility) is explained. Evidence relevant to the Minister's arguments is presented. In addition, the budgetary flexibility accorded to equivalent organisations to INI in Scotland is presented.

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[1] DETI (2009) 'Independent Review of Economic Policy' available online at: http://www.detini.gov.uk/independent_review_of_economic_policy-2.pdf (accessed 17 October 2012) (see page 165)

[2] IREP, page 165

[3] The Minister's letter is attached at Appendix 1 for ease of reference

1. The Northern Ireland Executive's budget flexibility

As a devolved administration within the UK public expenditure control system, the Northern Ireland Executive (along with the other devolved administrations) is given a degree of budgetary flexibility. The devolved administrations have slightly less restrictive arrangements than Whitehall departments in this regard.

The system that now operates – Budget Exchange – was announced by the UK Chancellor of the Exchequer in his March 2011 Budget. It replaced the previous system – End-Year Flexibility (EYF) – which was abolished in the Spending Review 2010. At that time, all existing stocks of EYF were cancelled.[4]

This section of the paper explains the Budget Exchange rules and the arrangements for in-year monitoring and control of public expenditure in Northern Ireland. This information forms important background to the Minister of Finance's position in relation EYF for INI.

1.1. Budget Exchange

The arrangements for the devolved administrations concerning the new Budget Exchange system were agreed by devolved Finance Ministers and the Chief Secretary to the Treasury in July 2011. The principles behind the modified version of the Budget Exchange system were based on the Northern Ireland Finance Minister's proposals and offered the devolved administrations a less prescriptive alternative to the otherwise robust budget exchange rules which apply to Whitehall departments.

The devolved administrations are able to carry forward Resource DEL and Capital DEL cash underspends and draw down these underspends in the following year up to maximum of **0.6% of Resource DEL** and **1.5% of Capital DEL**, through a Supplementary Estimate in the following year. The Northern Ireland Executive's resource DEL for 2012-13 is £10,353.4m; 0.6% of this equates to a maximum carry forward of approximately £62.1m. Capital DEL (net of receipts) for this year is £1,172.5m;[5] 1.5% of this equates to a maximum carry forward of approximately £17.6m.

The devolved administrations can if they wish inform the Treasury about planned underspend in advance of the year end and take up the carry-forward in the Main Estimate, within the above limit.

It was agreed by devolved Finance Ministers and the Chief Secretary to the Treasury that **these arrangements will not be reopened during the current Spending Review Period**; therefore the caps on Resource DEL and Capital DEL are non-

[4] See BBC News, 14 January 2011 '£300m 'swiped from NI to sort Treasury' says Wilson' http://www.bbc.co.uk/news/uk-northern-ireland-12182119 (accessed 17 October 2012)

[5] Source: 2012-13 DEL figures from Tables 3.1 and 3.2 of Budget 2011-15

negotiable for until the next Spending Review.[6] This is likely to occur during either 2013 or 2014.

1.1.1. INI's requirement for EYF

In the Committee's evidence session with the Chief Executive and Chairman of INI on 31 May 2012, it was proposed that a carry-forward figure of **£10-15m** provide the necessary level of flexibility. It was argued by the representatives of INI that £10-15m is small in terms of the whole NI block.

Whilst this may be true, it is arguable that using the entire block as a comparator is to make the wrong comparison. A more relevant comparison is the Northern Ireland Executive's Budget Exchange limit. **A carry-forward of £15m would be approximately one quarter of the Executive's entire Budget Exchange facility for resource DEL**.

If it were in the capital expenditure category, **£15m would represent about 85% of the Executive Budget Exchange facility for capital DEL.**

The INI representatives also argued that because of the central importance of INI's role to a number of key PfG commitments it would be appropriate to extend the organisation more flexibility. Again, this may well be a valid argument, but it should be thought about relative to Budget Exchange limits, not the entire Northern Ireland Block.

1.1.2. INI's requirement for other budgetary flexibilities

Subsequent to the evidence session with the Committee, INI provided an assessment of a case for increased flexibilities and discussed a number of options. In addition to the argument for EYF, INI also set out a number of other budgetary restrictions which it argued *"diverts activity away from Invest NI's primary purpose of driving economic development."*[7]

Other issues raised by INI included:

- The number of budget lines (in excess of 30) that INI has to manage and restrictions on movements of funds between lines;
- Current budgetary tolerances (maxima of 2% underspend on resource, and 3% underspend on capital, and 0% overspend);
- The timing of the returns for the January monitoring round effectively 'locks' INI's budget from November to the following April;
- INI's contractual commitments span a number of financial years;

INI set out a number of options for change to help manage these difficulties. Its preferred option was:

[6] Source: communication from Treasury official to RaISe, 12 August 2011.
[7] INI paper for Committee for Enterprise, Trade and Investment, '*Invest NI Budget Management*' 15 June 2012, paragraph 2.1.

Option 5 – Provide budget independence over the Spending Review (SR) periods

5.1. This option considers allocating a fixed budget to Invest NI over the full term of the SR period.

5.2. Within this fixed budget, Invest NI would be measured against key performance targets & indicators across the four year budget period, jobs promoted, R&D investment levels, etc as per the PfG targets. Delegated authority limits would remain unchanged. There are three key elements to this option, they are;

a. ***Allocating block funding*** *- by allocating a block of funding to Invest to undertake its activities this would greatly simplify the framework within which Invest NI operates.*

b. ***A reduction in the number of budget lines*** *used to monitor Invest NI's financial performance. There should essentially be two budget lines for capital (assets, investments and capital grants) and resource (grants expended or costs incurred), with the exception of the requirement to report on EU expenditure, receipts and non-cash. The administration budget should be amalgamated into the resource budget as administration is included in DETI's Resource budget. Again Scottish Enterprise is allocated a total resource budget, including admin, with minimal capital at the beginning of each period. Scottish Enterprise then seeks to move resource into capital as and when required for individual capital investment projects; and*

c. ***Retention of receipts*** *would provide greater flexibility to self-finance projects without the recourse to request additional budget through the monitoring round process. This would therefore be a more flexible and responsive solution to address funding issues.*[8]

Sub-section 1.2 examines the public expenditure controls and flexibilities in place in Northern Ireland as this helps to provide context for consideration of INI's preferred option.

1.1.3. The statutory basis for INI funding

INI was established as a non-departmental public body (NDPB) by the *Industrial Development Act (NI) 2002.* The financial arrangements are set out in Schedule 1 to that Act:

[8] INI paper for Committee for Enterprise, Trade and Investment, '*Invest NI Budget Management*' 15 June 2012, paragraphs 5.1. and 5.2 (page 9)

16.—(1) The Department may make payments to INI out of money appropriated for the purpose.

(2) Payments under this paragraph shall be made on such terms and conditions as the Department may, with the approval of the Department of Finance and Personnel, determine.

(3) INI shall not borrow money.

(4) Subject to sub-paragraph (5), INI shall pay to the Department all sums received by it in the course of, or in connection with, the carrying out of its functions.

(5) Sub-paragraph (4) shall not apply to such sums, or sums of such description, as the Department may, with the approval of the Department of Finance and Personnel, direct.

(6) Any sums received by the Department under sub-paragraph (4) shall be paid into the Consolidated Fund.

17.—(1) INI shall—

(a)keep proper accounts and proper records in relation to the accounts; and,

(b)prepare a statement of accounts in respect of each financial year..

(2) The statement of accounts shall—

(a)be in such form; and.

(b)contain such information,

as the Department may, with the approval of the Department of Finance and Personnel, direct.

(3) INI shall, within such period after the end of each financial year as the Department may direct, send copies of the statement of accounts relating to that year to—

(a)the Department; and,

(b)the Comptroller and Auditor General.

(4) The Comptroller and Auditor General shall—

(a)examine, certify and report on every statement of accounts sent to him by INI under this paragraph; and,

(b)send a copy of his report to the Department.

> *(5) The Department shall lay a copy of the statement of accounts and of the Comptroller and Auditor General's report before the Assembly.*[9]

There are two particular provisions in this legislation that seem particularly relevant to the issue of INI's budgetary flexibility:

- Paragraph 16(2) establishes that the funding paid to INI by the Department of Enterprise Trade and Investment (DETI) must be made in accordance with terms and conditions determined by DETI, with DFP's approval. In other words, it is for DETI and DFP to agree the appropriate terms and conditions to be attached to INI's funding. This suggests that the number of INI budget lines, for example, are determined by DETI, with DFP approval; and,
- Paragraph 16(4) provides that INI's receipts must be transferred to DETI, subject to any approved retention of receipts permitted by direction under 16(5). In other words, if DETI and DFP wished to allow INI to retain receipts, it appears that it could be provided for under such a direction.

The cash grant to fund INI is included in DETI's Estimate, approved each year by the Assembly via the Budget Bill and Supply resolution. At the same time, a limit on Accruing Resources (i.e. receipts and income) that may be retained by departments is also set by the Assembly. This limit applies to the parent department of the NDPB, rather than to the NDPB itself.

This means that the Accruing Resources that INI brings in do **not** count against DETI's approved limit in the Estimates. If it were to bring in a higher level of receipts than forecast, these would be managed under the in-year monitoring process (see 1.2. below) and be returned to the Executive for reallocation.

1.1.4. Managing Public Money

The governing principles for how NICS departments and their sponsored public bodies must manage resources are set out in DFP's document *Managing Public Money Northern Ireland.* This states:

> *In practice NDPBs operate with some independence and are not under day-to-day ministerial control. Nevertheless, ministers are ultimately accountable to the Assembly for NDPBs' efficiency and effectiveness. This is because ministers: are responsible for NDPBs' founding legislation; have influence over NDPBs' strategic direction; (usually) appoint their boards; and have the ultimate sanction of winding up unsatisfactory NDPBs.*[10]

Departments' budget structures (i.e. the number of budget lines) are examined during large budget exercises like those conducted around the time of UK Government

[9] http://www.legislation.gov.uk/nia/2002/1/schedule/1/crossheading/finance (accessed 20 November 2012)
[10] DFP (2008) 'Managing Public Money Northern Ireland' available online at: http://www.dfpni.gov.uk/index/finance/afmd/afmd-key-guidance/afmd-mpmni/mpm_chapters.pdf (accessed 20 November 2012) (see paragraph 7.7.4)

spending reviews. The structure of the budget of an NDPB and the number of lines reflects the level of assurance that the parent department and minister feel is needed. This is a negotiated process between the department concerned, DFP and the NDPB.

It follows then, for INI to reduce the number of budget lines it has to manage and report against, it will need to make the case strongly to DETI when the next budget exercise is conducted.

1.2. The in-year monitoring and control of public expenditure

The Northern Ireland Executive's *Budget 2011-15* set out departmental budget allocations for a four-year period, aligned to that in the UK Government's Spending Review 2010. This set expenditure ceilings for departments, and departments aligned their spending plans and strategic priorities according to the budget outcome.

Over a four-year period, however, priorities may change and unforeseen expenditure pressures (i.e. shortage of funding to meet a particular need) or easements (i.e. excess funding over what is now required for a particular purpose) may arise. Consequently, the Executive operates a system of in-year monitoring to help to manage the pressures by reallocating resources released through easements.

The Department of Finance and Personnel (DFP) publishes guidance for departments on the in-year monitoring process. This states that:

> *The in-year monitoring process provides a formal system for reviewing spending plans and priorities for each financial year in light of the most up to date position. It therefore aides good financial management and ensures that resources are directed towards the highest priority areas. The process is not intended to facilitate the re-opening of the agreed Budget position and* ***departments must treat all allocations set in the course of the Budget process as ceilings, and should seek to manage their activities to contain spending within those ceilings, unless and until any increase is agreed by the Executive.***[11]

1.2.1. The in-year monitoring timetable

There are three routine in-year monitoring rounds for 2012-13: June, October and January. The DFP guidance also notes that:

> *…it may be necessary, in light of emerging public expenditure pressures throughout the year, to commission ad hoc monitoring rounds or to adjust the timing of planned monitoring rounds.*[12]

[11] DFP (2012) 'In-year Monitoring of Public Expenditure: 2012-13 Guidelines' available online at: http://www.dfpni.gov.uk/in-year-monitoring-of-public-expenditure-2012-13-guidelines.pdf (accessed 17 October 2012) (see page 4)
[12] DFP (2012) 'In-year Monitoring of Public Expenditure: 2012-13 Guidelines' available online at: http://www.dfpni.gov.uk/in-year-monitoring-of-public-expenditure-2012-13-guidelines.pdf (accessed 17 October 2012) (see page 6)

It is possible therefore that certain expenditure needs might trigger an additional monitoring round. DFP has confirmed that **this would only occur in exceptional circumstances involving a very significant emerging pressure that requires immediate action**: the pressure would need to be so significant that the department with policy lead could not address through internal reallocation and that action would be required immediately. Otherwise any issues can be addressed through the normal monitoring timetable.[13]

It is theoretically possible, then, that if INI urgently required funds, an additional monitoring round could be scheduled.

1.2.2. Public expenditure controls

There are a number on controls on public expenditure which apply to NICS departments and other public bodies. Within these controls, there is limited flexibility for departments to make certain changes to their spending plans without needing the approval of either DFP or of the Executive. The most relevant of these controls and flexibilities are detailed in Box 1:

Box 1: budgetary controls and flexibilities[14]

<u>*De minimis* threshold</u> – the current threshold above which a monitoring bid or reduced requirement must be submitted to DFP is £1m. The general rule is that pressures below that level must be met from within existing budget allocations. By the same token, reduced requirements of less than £1m may be reprioritised by the department itself, subject to controls on particular categories of spending (such as ring-fenced funds, or movements from capital to resource, for example);

<u>Movement of resources</u> – any movement of resources between resource and capital DEL require Executive approval. Departments cannot reallocate resources due to reduced requirements that should be surrendered;

<u>Reduced requirements</u> – all reduced requirements above the *de minimis* threshold must be surrendered to the centre. Reduced requirements may arise from a number of sources including increased levels of receipts from fees/charges; unplanned asset sales; a function requiring less than its existing provision; savings from changes to pay/price assumptions; or, a decision to reduce or cease delivery of a function or service;

<u>Bids</u> – where departments identify expenditure pressures above the *de minimis* threshold, they may make monitoring round bids for additional funds. Bids must demonstrate impact on Programme for Government commitments, consistency with departmental priorities and objectives, and be compliant with equality duties;

<u>Category switches</u> – in certain circumstances and subject to appropriate Executive or DFP approvals, funds can be switched between spending categories, such as from administration to frontline services. Movements from resource DEL to capital DEL require Executive approval;

<u>Reduction and reallocation</u> – departments are able to put forward proposals to DFP Supply to limit expenditure on one service in order to release resource to meet other priorities as a result of **proactive management decisions** (again subject to necessary approvals if there are category switches involved, for example);

[13] Source: communication from DFP official

[14] Note that the DHSSPS has some additional flexibilities as agreed in Budget 2011-15. For example, it may automatically retain reduced requirements and reallocate within the same category of spend to higher priority areas. But DHSSPS is **not** allowed to bid for resource monies except in the event of "*major and unforeseeable circumstances*."

Reallocation within Unit of Service – resources may be reallocated within the same Unit of Service and category of spend without Executive approval; and,

Technical transfers – this is the movement of resources between NICS departments, or between NICS and UK government departments.

There are two further notable restrictions. Firstly, **additional receipts** above the level planned in the Budget position may not be offset against expenditure. This means accurate forecasting is extremely important. Secondly, **ring-fenced resources** that have been allocated for a specific purpose may not be redirected. Examples include allocations under the Childcare Strategy or the Social Investment Fund.

These controls are particularly relevant to INI's case for flexibility to switch resource funding to capital – see section 1.3.1.

1.2.3. Outturn and forecast outturn

In his letter of 18 July 2012, the Minister of Finance stated that "*better forecasting is essential and would to a large extent obviate the need for EYF.*" The in-year monitoring guidelines require departments to provide monthly outturn (i.e. what has actually been spent to date) and forecast outturn (i.e. what departments forecast will be spent in each month to year end) returns to DFP.

DFP has recently provided the Committee for Finance and Personnel with analysis of departmental forecasting performance in the 11-12 financial year. This is presented and discussed below in section 3.1.

1.2.4. Provisional outturn and End-Year Flexibility

In mid-May, departments must provide provisional outturn for the preceding financial year. The provisional outturn becomes final following the completion and auditing of resource accounts. Provisional outturn, and forecast outturn provide the information needed by DFP to manage to Budget Exchange scheme on behalf of the Northern Ireland Executive. The monitoring rounds guidance states that:

> *To enable DFP to effectively manage this process with HM Treasury* ***it is critically important that departments ensure that they minimise end of year underspends and surrender reduced requirements at an early stage.*** *Any end of year underspends at Block level above the Budget Exchange Scheme limits will be lost to Northern Ireland and sound financial management by departments is critical to ensure that this does not happen.*[15]*[emphasis added]*

[15] DFP (2012) 'In-year Monitoring of Public Expenditure: 2012-13 Guidelines' available online at: http://www.dfpni.gov.uk/in-year-monitoring-of-public-expenditure-2012-13-guidelines.pdf (accessed 17 October 2012) (see page 34)

This extract may help to explain the reluctance of the Minister of Finance to extend an EYF facility to INI: there is evidently a risk to the Executive that an allowance to carry forward resources for one department might be undermined by the level of underspends recorded across the NICS as a whole.

The outworking of higher-than-expected levels of underspend could be resources being returned to the Treasury rather than being re-allocated within Northern Ireland. If the Executive allocated a large proportion of its Budget Exchange flexibility to INI, it would be restricted in the carry forward it could allow other departments or bodies.

1.3. Discussion

This section provides some discussion of the options put forward by INI and the implications for the current public expenditure system.

1.3.1 Flexibility to switch resource to capital

The rules for public expenditure controls as set out in the monitoring round guidance require Executive approval for shifts of resource money into capital. INI has identified that Scottish Enterprise is able to achieve this:

> *In Scotland initial capital allocations are deliberately held low on the basis that revenue can easily be exchanged for capital if the need arises.*[16]

INI has therefore identified that its flexibility could be increased by following a similar system. There would, however, be consequences for DFP's management of resources at the Northern Ireland Block level. If INI were allocated a larger proportion of resource funding and a smaller proportion of capital – on the basis that it could switch if the need arose – DFP would still have to balance the resource and capital split required under the Spending Review 2010 settlement.

While Treasury rules do permit the Executive to switch resource to capital funding, a difficulty could arise if (to adopt INI's terminology) the need to do so did **not** arise. If INI were allocated more resource funding, but then did not need to switch to cover capital expenditure, it would be left with a surplus to hand back to the centre as a reduced requirement.

If this occurred at January monitoring, the Executive would then potentially have additional resource funds to try to spend in an ad-hoc manner, rather than in a planned way. Because the Executive's carry-forward limit under Budget Exchange is relatively low compared to the old EYF system, it could end up having to return unspent resources to the Treasury which might (from a Northern Ireland perspective) be better used by another public body in Northern Ireland.

[16] INI paper for Committee for Enterprise, Trade and Investment, 'Invest NI Budget Management' 15 June 2012, paragraph 3.2 (page 8)

1.3.2. Retention of receipts

Another option put forward by INI is to allow it to retain greater levels of receipts without having to seek additional budget through monitoring round bids. Ultimately, receipts which are authorised for use by a public body are netted off the cash required by that body to pay for the services it provides. In INI's case, increased receipts – if retained – could lead to a smaller cash grant being required, or greater spend by INI without additional funds from the Executive.

As explained above, additional receipts must currently be surrendered in monitoring rounds. This allows the Executive to examine **all** the resources available for redistribution and to prioritise. If INI were allowed to instead retain higher levels of receipts, the effect on the Executive would be that it did not get an opportunity to decide how those resources should be applied. (see also section 3.2.2. below)

This system does not provide much incentive for INI to maximise its income. The Committee may wish to note that DFP has proposed changes to the public expenditure system under the *Review of Financial Process.* This included two recommendations that may be relevant to the current issue.

Firstly, DFP recommended that NDPBs are consolidated within the departmental accounting boundary. This would have the effect of bringing INI's expenditure and Accruing Resources limit fully within DETI's Estimate. Secondly, DFP recommended that in future the Assembly votes **net** controls on expenditure.[17]

Net voting was introduced in Westminster under the Treasury's *Alignment Project* which DFP's recommendation mirrors. When the Treasury brought this forward, it argued that:

> *Moving to net voting will offer a number of significant benefits. The change will align parliamentary controls with Treasury controls over departmental spending, will avoid the risk that unanticipated income late in the year might be lost and will maintain incentives on departments to seek best value for money by maximising income where it is appropriate to do so. These new provisions will apply only to departments.* ***NDPBs are already able to retain any income they generate, and no new controls are planned.*** [18]*[emphasis added]*

The cited text above highlights a difference in the Northern Ireland financial management arrangements from those at the UK level.

In addition, DFP's discussion paper on the *Review of Financial Process* noted:

[17] DFP (2011) 'Review of the Financial Process in Northern Ireland – discussion paper for key stakeholders' (recommendation 5)

[18] HMT(2010) 'Q & A brief for Departments and associated bodies' available online at: http://www.hm-treasury.gov.uk/d/qa_brief_for_depts_hmt_public_august_2010.pdf (accessed 2 August 2011) (see page 5)

On a purely practical note, if the Assembly voted 'Net' controls, departments would be relieved of the seemingly futile administrative burden of surrendering excess accruing resources (above the Assembly limit) to the Consolidated Fund.[19]

This statement suggests that DFP views the current arrangements to be sub-optimal and there *may* therefore be some scope for INI's proposed option to be accommodated.

Finally, it should be noted that Scottish Enterprise has advised RaISe, that it is permitted to retain its receipts, subject to approvals:

We retain our receipts but must spend them in year. What we don't spend goes back to our parent department. If we generate higher-than-anticipated level of receipts then the difference goes back to our parent department unless we have had approval from that department to retain those receipts - these also must be spent in year.[20]

Issue for consideration: the Committee may wish to consider asking DETI and DFP for a view on whether NDPBs (generally) or INI (specifically) should be allowed to retain receipts. This might provide INI with a greater incentive to improve performance in addition to making its financial management more straightforward.

[19] DFP (2011) 'Review of the Financial Process in Northern Ireland – discussion paper for key stakeholders' paragraph 55, page 29)

[20] Source: communication from Scottish Enterprise official

2. The Scottish Government's budget flexibility

2.1. Budget Exchange

As noted above in section 1.1., the Scottish Government has the same degree of budget flexibility at block grant level as the Northern Ireland Executive. The same caps on carry forward of underspend apply.

2.2. INI's equivalent bodies in Scotland

This section details the budgetary flexibilities available to the public bodies in Scotland that deliver functions equivalent to INI:

- Scottish Enterprise; and,
- Highlands and Islands Enterprise;

2.2.1. Scottish Enterprise

Scottish Enterprise sets out its role in the following terms:

> *We work to*
>
> - *Stimulate economic growth - delivering dedicated support locally, nationally and internationally.*
> - *Exploit low carbon opportunities - we are working with partners to create a competitive low carbon business environment in Scotland.*
> - *Improve Scotland's business infrastructure - ensuring Scotland has a great business environment for companies to grow and attract new investment to Scotland.*
> - *Support business - offering tailored support to businesses of all sizes. Support includes products, services, funding and investment opportunities.*[21]

The *Management Statement and Financial Memorandum* between the Scottish Government's Business Directorate and Scottish Enterprise states:

> *In principle the Scottish Government's end-year flexibility (EYF) arrangements allow for unused DEL budgetary provision to be carried forward, in part or in full, from one financial year to the next.* ***However, given the many competing demands for resources the availability of EYF should be regarded as highly exceptional.*** *SE should therefore manage its use of DEL budgetary provision accordingly. SE must at the*

[21] http://www.scottish-enterprise.com/about-us/what-we-do.aspx

earliest opportunity submit to the sponsor Directorate any proposals for carrying forward budgetary provision.[22] *[emphasis added]*

This statement strikes a remarkably similar tone to the Minister of Finance's views as outlined in his letter of 18 July 2012 – i.e. – Scottish Enterprise may be able to avail of EYF, but there are other competing demands.

An additional provision of the *Management Statement and Financial Memorandum* protects the sponsor Directorate from overspends:

The extent to which SE exceeds agreed total resource and capital budgets shall normally be met by a corresponding reduction in the budget(s) for the following financial year.[23]

2.2.2. Highlands and Islands Enterprise

HIE's priorities are:

Across the region, we will pursue four priorities:

- *Supporting businesses and social enterprises to shape and realise their growth aspirations*
- *Strengthening communities and fragile areas*
- *Developing growth sectors, particularly distinctive regional opportunities*
- *Creating the conditions for a competitive and low carbon region*[24]

The *Management Statement and Financial Memorandum* between the Scottish Government's Business Directorate and Highlands and Islands Enterprise is identical in relation to EYF, except for the name of the agency:

In principle, the Scottish Government's end-year flexibility (EYF) arrangements allow for unused DEL budgetary provision to be carried forward, in part or in full, from one financial year to the next. However, given the many competing demands for resources the availability of EYF should be regarded as highly exceptional. HIE should therefore manage its use of DEL budgetary provision accordingly and shall at the earliest opportunity submit to the sponsor Directorate any proposals for carrying

[22] Scottish Enterprise (2010) 'Management Statement and Financial Memorandum between the Scottish Government's Business Directorate and Scottish Enterprise' available online at: http://www.scottish-enterprise.com/~/media/SE/Resources/Documents/MNO/management-statement.ashx (accessed 23 October 2012) (see page 19)

[23] Scottish Enterprise (2010) 'Management Statement and Financial Memorandum between the Scottish Government's Business Directorate and Scottish Enterprise' available online at: http://www.scottish-enterprise.com/~/media/SE/Resources/Documents/MNO/management-statement.ashx (accessed 23 October 2012) (see page 19)

[24] http://www.hie.co.uk/about-hie/our-priorities/default.html

> *forward budgetary provision. Any such proposals shall be considered in the light of competing priorities.*[25]

The *Management Statement and Financial Memorandum* for HIE makes the same provision for overspends as does Scottish Enterprise's Memorandum.

2.3. Does the 'Scottish Model' offer greater flexibility?

In a paper provided to the Committee by INI, it highlighted the ability of Scottish Enterprise to use resource funding to supplement its capital budget. This position is set out in the Scottish Government's Draft Budget 13-14:

> *What the budget does*
>
> *The Enterprise budget is focused on supporting growth companies, growth sectors and growth markets. In line with our aim to accelerate recovery through boosting public sector capital investment, Scottish Enterprise (SE) and Highlands and Islands Enterprise (HIE) will continue to have the flexibility to use resource budget to support capital projects. On current estimates for 2013-14, we expect the enterprise bodies to supplement their capital programme through switching somewhere between £40 million and £75 million from resource to capital budgets, plus using over £50 million of capital receipts.*[26]

This extract confirms the position as set out by INI in regard to the ability of Scottish Enterprise to switch funds between budget categories – as discussed above in section 1.3.1. **This is *in-year*, rather than *end-year* flexibility**.

In relation to the Scottish agencies' ability to make use of EYF, the extracts cited above in 2.2.1. and 2.2.2. clearly state that **access to EYF would not be routinely allowed**.

When representatives of INI appeared before the Committee in May 2012, it was suggested that Scottish Enterprise had the ability to carry-forward underspends, and had done so, to the value of £20m. Scottish Enterprise has explained that this facility was only in connection to a specific fund that was established, and not to the generality of its budget. The £20m figure:

> *…relates to the Scottish Co-investment Fund, whose public sector co-finance (£20m) was deemed outside of [Resource Account Budgeting] when the Fund was set up in 2003. It was a condition of [the European Regional Development Fund (ERDF)] grant at the time that we set up a separate bank account and put all of the £20m in it before we could draw down ERDF of £28m.* ***I do not believe that this arrangement still***

[25] HIE (2010) 'Management Statement and Financial Memorandum between the Scottish Government's Business Directorate and HIE', available online at: http://www.hie.co.uk/common/handlers/download-document.ashx?id=b2b006c1-2967-4d1a-b1b1-7982957f5596 (accessed 23 October 2012) (see page 20)

[26] http://www.scotland.gov.uk/Resource/0040/00402310.pdf

> ***stands**. We also manage the Scottish Seed Fund (invests up to £150k per company) and the Scottish Venture Fund (invests up to £2m per company) and **these are annual budgets which must be spent in-year**, as per UK Treasury rules.*[27] *[emphasis added]*

This response means that, whilst it was previously the case that Scottish Enterprise could carry-forward resources in relation to that specific Fund, it is no longer able to do so. However, the arrangements for the Scottish Co-investment Fund may arguably be seen as a precedent that more flexible arrangements can be – or *could previously have been* – established.

Issue for consideration: the Committee may wish to seek the views of INI and DETI to establish whether a similar arrangement might be possible. It should be noted that the Scottish Co-investment Fund was part-funded by Europe, and this may have a bearing on the applicability of this model in Northern Ireland.

[27] Source: communication from Scottish Enterprise official.

3. Further evidence

This section of the Paper presents further information that may be of relevance to the Committee's consideration of the case for increased INI budgetary flexibility. Presented below is:

- Analysis of DETI's financial forecasting performance in 2011-12;
- Evidence of INI's success in monitoring rounds; and,
- Analysis of INI's actual expenditure/letters of offer.

3.1. DETI's financial forecasting performance 2011-12

It was mentioned above in section 1.2.3. that DFP had provided analysis of forecasting accuracy to the Committee for Finance and Personnel.[28]

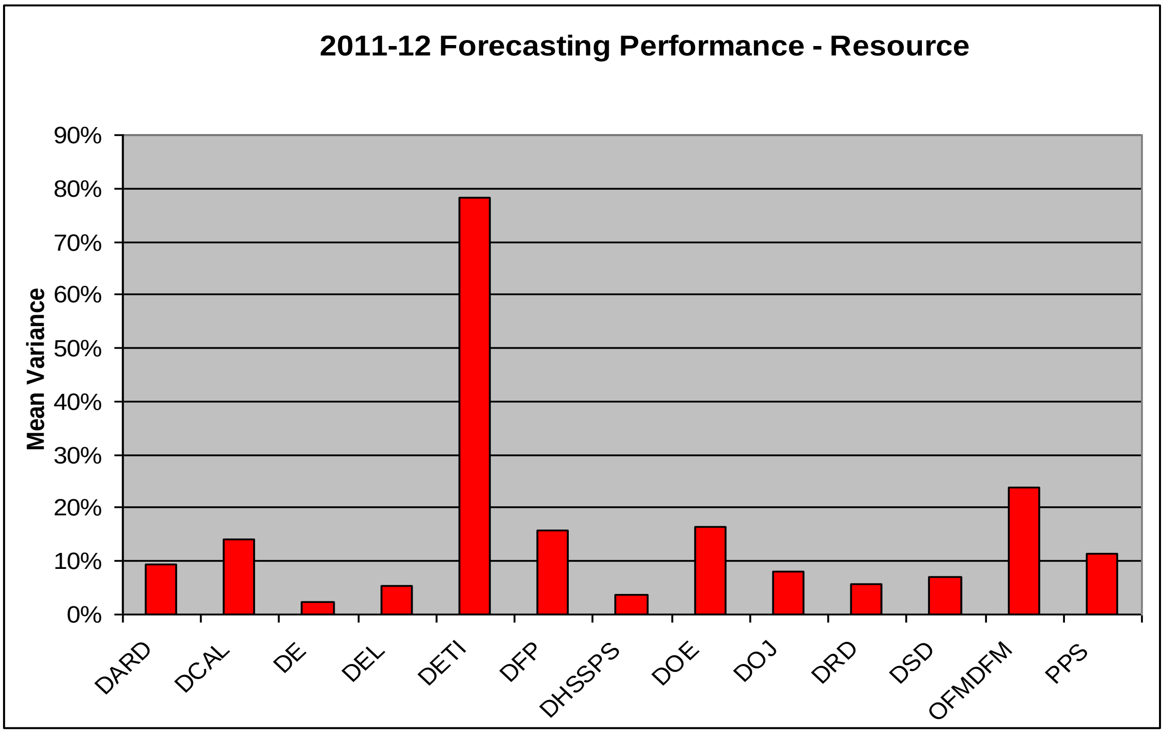
This is reproduced here. DFP provided some points to note in interpreting the charts:[29]

- The summary charts show the average "absolute" percentage difference between actual expenditure and the last forecast provided. This is based on the information reported to DFP by the departments during the 2011-12 financial year.
- Since the variance between actual and forecast expenditure in each month may be positive or negative, it was necessary to calculate the "absolute" percentage difference when computing the average over the 10 months. This does not take away from the analysis since the important factor is whether each department accurately forecasted expenditure and not whether actual spend exceeded, or fell below, the forecast in a particular month. Clearly, departments with a relatively low average percentage variance performed better than those with a relatively high score.

[28] Source: DFP letter to CFP, 6 September 2012 (ref: MISC72/11-15)
[29] Source: DFP letter to CFP, 6 September 2012 (ref: MISC72/11-15)

Non-ringfenced Resource Expenditure

Chart 1: Average Absolute Variance: Forecast V Actual - Resource

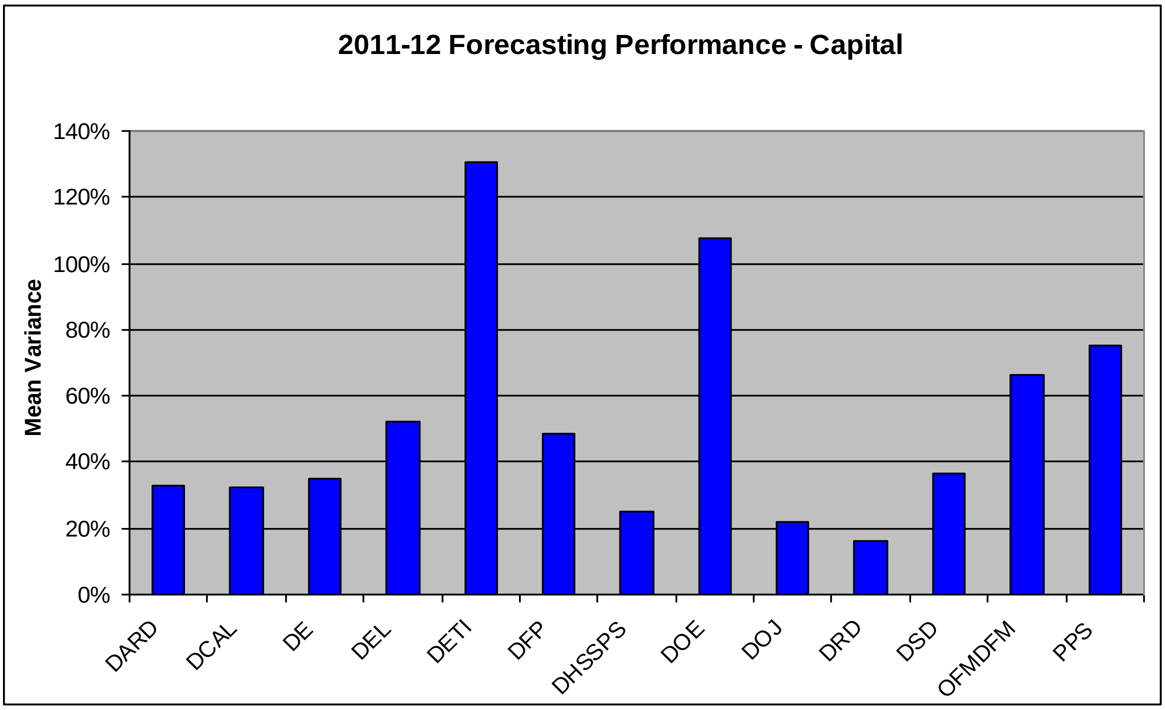


<u>Note</u>: The DETI forecasts appear to have been impacted heavily by the reclassification of £50 million from resource to capital in relation to the Presbyterian Mutual Society rescue package. If this PMS issue is stripped out the DETI mean variance reduces to 15.5%.

The **mean variance** between forecast and actual expenditure (reported two months after the forecast) for all departments over all of the 10 months June 2011 to March 2012 was **15.5%.**

Capital Expenditure

Chart 2: Average Absolute Variance: Forecast V Actual - Capital

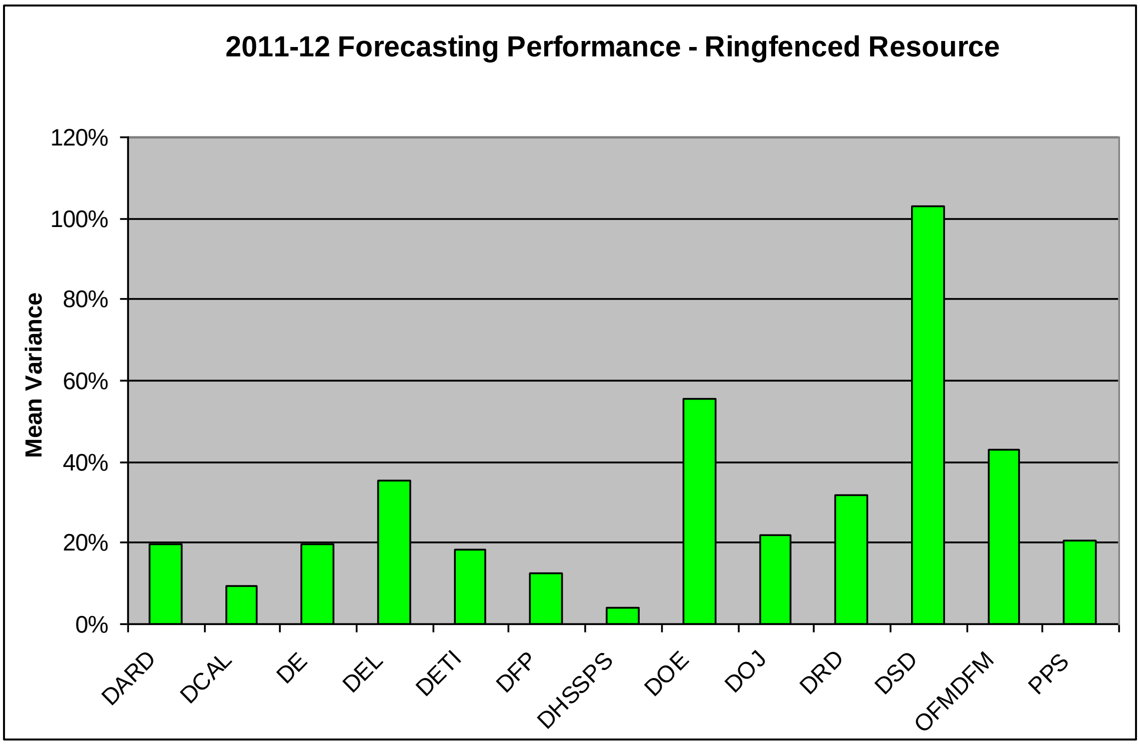


<u>Note</u>: The DETI forecasts appear to have been impacted heavily by the reclassification of £50 million from resource to capital in relation to the Presbyterian Mutual Society rescue package. If this PMS issue is stripped out the DETI average variance reduces to 55.8%.

The **mean variance** between forecast and actual expenditure (reported two months after the forecast) for all departments over all of the 10 months June 2011 to March 2012 was **52.4%**.

Ringfenced Resource

Chart 3: Average Absolute Variance: Forecast V Actual – Ringfenced Resource



The **mean variance** between forecast and actual expenditure (reported two months after the forecast) for all departments over all of the 10 months June 2011 to March 2012 was **30.4%**.

3.1.1. Points to note

The following observations may be made in relation to DETI's forecasting performance in 2011-12:

- If the PMS reclassification issue is ignored, DETI's variance of 15.5% between forecast and actual expenditure was **equal to the NICS departmental average** for **non-ringfenced resource** expenditure;
- If the PMS reclassification issue is ignored, DETI's variance of 55.8% between forecast and actual expenditure was **slightly higher than the NICS departmental average** of 52.4% for **capital** expenditure; and,
- DETI's variance of less than 20% between forecast and actual expenditure was **significantly lower than the NICS departmental average** of 30.4% for **ring-fenced resource** expenditure.

The Minister's letter of 18 July 2012 states that:

> *…there is a danger that EYF can sometimes be used as a substitute for good financial management. Better forecasting is essential and would to a large extent obviate the need for EYF.*

This statement appears to suggest that it is the Minister of Finance's view that if DETI's forecasting performance were better, there might not be a need for an EYF facility for INI.

The following section looks at the evidence of INI's history of monitoring round bids and easements.

3.2. Evidence of INI's success in monitoring rounds

Given the apparent reluctance of the Minister of Finance to extend an EYF facility to INI, it may be interesting to the Committee to examine the evidence of previous monitoring exercises. In his letter, the Minister stated that:

> *In the past, bids from INI to support business have been given high priority by the Northern Ireland Executive and there is no reason for this to change in the future.*

Establishing whether INI has previously been successful in monitoring bids *may* therefore important in examining the case for additional budgetary flexibility. But **Members may wish to note that past success/failure may not always be a reliable indicator of future success/failure**; in each monitoring round, bids must be evaluated in the context of competing bids from other business areas or departments. Therefore, just because *previously* INI bids have been successful, does not mean that in future they may be considered of a higher priority than competing bids.

Having said that, economic development is afforded a high level of policy commitment in the Programme for Government. This may mean that INI has a better chance of securing funding in future monitoring rounds than other departments or public bodies.

3.2.1. Bids for resources 2008-09 to 2012-13

DETI has confirmed that **all Invest NI monitoring round bids submitted during the period 2008-09 to 2012-13 were met by the Executive**.[30] These are shown in Table 1:

Table 1: History of bids 2008-2012

£ million	Resource	Capital
2008-09	6.8	1.4
2009-10	1.9	22.8
2010-11	4.6	28.0

[30] Source: communication from DETI official

DETI has also commented that:

Included within in these were specific allocations made in regard to the Bombardier C Series project. These totalled £22.3m in 2009-10 and £28m in 2010-11. The amounts were subsequently transferred to the Department of Business Innovation and Skills to assist in the funding of the Launch Investment aspect of the project.[31]

3.2.2. Easements 2008-09 to 2012-13

DETI has also confirmed the level of INI easements from 2008-09 to 2012-13. These are shown in Table 2:

Table 2: History of easements 2008-09 to 2012-13

£ million	Resource	Capital
2008-09	£12.0	£11.5
2009-10	£14.1	£3.3
2010-11	£0.9	£2.6
2011-12	£10.9	£22.8
2012-13*	£4.9	£3.0

*** year to date**

DETI has also commented that:

In addition, in the current year, £9.5m ring-fenced 'Invest to Save' Resource funding, which had been put into the Invest NI budget pending resolution of how and who could deliver a solution in relation to the nitrates disposal issue, has also been returned.

The main reason for the easements has been the downturn in the global economy resulting in a loss in business confidence with project promoters delaying the implementation of their plans potentially into future years.

Invest NI also proactively generated additional receipts of £8.5m Resource and £12.6m Capital over this 5-year period. These receipts, which relate in the main to sales of shares, land and property and increased grant clawback are also treated as reduced requirements.[32]

It is noteworthy that this response highlights the issue of additional receipts having to be handed to the centre under in-year monitoring rules that was discussed in section 1.3.2. above.

[31] Source: communication from DETI official
[32] Source: communication from DETI official

3.3. Analysis of INI's actual expenditure/letters of offer

The Minister of Finance's letter stated that it will be "*a number of years before INI's actual expenditure catches up with letters of offer.*"

RaISe has requested analysis from INI of the profile of actual expenditure and letters of offer that have been made. The INI response is attached as Appendix 2.

In that response, INI describes the methodology used for estimating its budget requirement for the next two financial years. INI states it has "*a budget requirement in the region of £75m per annum."*

Secondly, INI's response sets out is budget allocations for 2013-14 and 2014-15.The recent budget realignment exercise conducted by DFP on behalf of the Executive led to changes in allocations for a number of departments. This delayed INI's response to RaISe whilst budget lines were adjusted. INI states that:

> *The budget allocations for 2013/14 and 2014/15 are £128m and £126m respectively. These figures are after deducting £9.2m in 2013/14 and £9.5m in 2014/15 for the budget reduction from DFP. The current projected budget requirements for the non-grant programmes are circa £50m in both 2013/14 and 2014/15.* ***That leaves a budget of approximately £75m going forward for grant related assistance which equates to our current forecast [Work in Progess] and assistance levels****.[33] [emphasis added]*

Simply put, this means that - it now transpires - that for the next two financial years INI believes its allocation is about right; it therefore would appear not to require an End-Year Flexibility facility after all – at least in the short term.

In Committee on 6 December 2012 (after the research for this paper had been completed), the INI Chief Executive confirmed that the future approach that he now considered appropriate was to rely on the monitoring round process on the understanding that the Executive will seek to meet any bids that INI might make.

[33] Source: communication from INI official

4. Concluding remarks and issues for consideration

The research presented in this paper has addressed a number of elements of INI's budgetary flexibility – both in-year and end-year. In addition to the information provided, a number of specific issues have been drawn to the Committee's attention for possible further consideration.

The brief for this research asked for identification of a way of finding budgetary flexibility for INI.

The Budget Exchange rules are clear. They are also fixed for the short term at the very least. Any facility to provide EYF to INI would need to operate within the controls set by the Treasury. So, unless an arrangement similar to Scotland Enterprise's Co-investment Fund (whereby the funding was held outside the usual government resource accounting framework) can be established, options appear to be limited to in-year flexibilities. Scottish Enterprise's other funds are subject to in-year spend requirements, just as are INI's. This suggests that in years to come, Scottish Enterprise may be faced with similar problems with budgetary management.

It may be that there is scope for greater in-year flexibilities – in particular around the retention of receipts or the ability to switch funds between category of expenditure. As discussed in the body of the paper, such options are likely to have implications for elsewhere in the public sector in Northern Ireland, and also for the Executive's management of the budget generally.

Appendix 1: Minister of Finance's letter to Committee Chair, 18 July 2012

From the Office of the
Minister for Finance & Personnel

Department of
Finance and
Personnel
www.dfpni.gov.uk

DFP Private Office
Craigantlet Buildings
Stoney Road
Belfast BT4 3SX

Telephone: 028 90163371

Email: private.office@dfpni.gov.uk

Your reference:
Our reference: COR/404/2012

Mr Alban Maginness MLA
Chair
Committee for Enterprise, Trade and Investment
Room 375
Parliament Buildings
Ballymiscaw
Stormont
Belfast
BT4 3XX

18 July 2012

Dear Alban

Thank you for your letter of 7 June which sets out your concerns in relation to the Invest NI budget and in particular in relation to the lack of End of Year Flexibility (EYF) arrangements. Your letter seeks my agreement to raising the issue with the Executive with a view to developing and agreeing proposals to provide Invest NI with appropriate levels of EYF.

I note your concerns and would take this opportunity to assure you that there is no loss of focus by the Executive or my Department on continuing to give the highest priority to the rebuilding and rebalancing of the NI economy. However, after due consideration I am content that our current approach of in-year review best serves our needs at present.

Taking into account the current economic downturn, there is a reluctance/inability for companies to draw on assistance offered as this involves significant investment at a time of such uncertainty. Given where we are in the current economic cycle, it will be a number of years before Invest NI's actual expenditure catches up with the letters of offer.

The proposed EYF arrangements would result in substantial unspent resources accumulating year on year and being set aside within Invest NI until such times as the current economic cycle concludes. At a time when both social and economic services are under extreme pressure such an approach would be inappropriate and potentially damaging. The Executive must focus on strategic priorities and given its own limited EYF, only recently secured, it would be indefensible to hand this over to a lower tier organisation.

A comparison has been made with the Scottish model. However, this is not appropriate since the public expenditure management arrangements are different here. The NI Executive operates the in-year monitoring process, which re-distributes resources throughout the financial year. Scotland does not operate an equivalent process. Additionally, there is the danger that EYF can sometimes be used as a substitute for good financial management. Better forecasting is essential and would to a large extent obviate the need for EYF.

Our approach to this issue does not mean undermining a focus on the economy. Invest NI`s needs alongside others will continue to be considered as part of the in-year process and the Executive will need to be ready to respond should the economic climate improve. In the past, bids from Invest NI to support business have been given high priority by the Executive in the monitoring rounds and there is no reason why that would change.

Yours sincerely

SAMMY WILSON MP MLA

Appendix 2: Invest NI Response to RaISe

AR 22/12: Assembly Research Query on End Year Flexibility

Budget Forecasting

The nature of Invest NI business is very complex with a significant portion of the budget requirements dependent on the demand for financial assistance from client companies. Predicting this level of demand and the subsequent drawdown on offers adds to the complexity of budget forecasting. Over the years we have built up statistics on grant drawdown patterns that have been used to provide a reasonableness check on the forecasted budget requirements. However over the period of the economic downturn, from 2008 to date, these drawdown patterns have changed. Some companies have delayed expenditure on supported projects, and particularly when this relates to a larger project, this can have a significant impact on the drawdown profile.

The future drawdown of financial support is predicated on two key elements; firstly the value of offers issued in previous years and second the value of work in progress for new projects.

Table 1 below displays data from 2007 to date. Work in progress relates to the current value of projects that are in the process of being assessed for financial assistance. As can be seen from the table WIP has decreased from 2008 to 2011, but has now started to pick up again and over the last twelve months has increased by 110%. Not all of these WIP cases will be converted into actual offers, and our analysis of past trends would indicate a conversion rate of circa 53%. The number of approved offers has increased over the last five years due to a greater number of smaller value offers, however the levels of assistance offered has fallen significantly since 2009-10 due to a fall in larger value projects. Specifically the 2008-9 figures included an offer for £21M to one company, and the 2009-10 year included £50M of offers to just five companies.

Table 1 – WIP and Financial Assistance

Year	Work in Progress Assistance (£m)	Number of Approved Offers	Assistance Offered (£m)
2007-08	152	2,149	110
2008-09	128	2,498	136
2009-10	97	3,629	177
2010-11	50	3,162	104
2011-12	88	4,344	89
2012-13 (Apr to Oct)	144	2,649	51

The current level of WIP at October 2012 is £144M. A forecast of WIP levels to meet our operating plan targets for jobs promoted has estimated that between £170M and £180M is the optimum level required to achieve the targets. Assuming that a level of £180M would be maintained going forward then the amount of assistance offered would be in the region of £95M per annum by applying the 53% conversion rate. Whilst £95M is lower than the assistance amounts as compared with the 2007-11 period there were a small number of very large projects during this period, as outlined above, which if excluded would result in an average of just under £100M of assistance offered per annum. An analysis of grant drawdown profiles has indicated that, under normal economic conditions, on average 75% to 80% of the total assistance offered is actually claimed and paid to companies. This would equate to a budget requirement in the region of £75M per annum.

There are several limitations with this approach. Firstly whilst there are tentative signs of economic recovery this is still very much at an early stage and the level of WIP and grant drawdown is therefore difficult to predict. Secondly, a significant share of the Invest NI budget has been accounted for by large companies which have a disproportionate impact on the budget projections if their plans differ from profile.
Thirdly and most importantly we have a range of other programmes and initiatives such as ‘Access to Capital’ funds, land development, sustainable development programmes, trade and overseas programmes. In 2012/13 the programme budget for these non-grant related activities account for circa £45M out of a total gross budget of £137M.

The budget allocations for 2013/14 and 2014/15 are £128M and £126M respectively. These figures are after deducting £9.2M in 2013/14 and £9.5M in 2014/15 for the budget reduction from DFP. The current projected budget requirements for the non-grant programmes are circa £50M in both 2013/14 and 2014/15. That leaves a budget of approximately £75M going forward for grant related assistance which equates to our current forecast WIP and assistance levels as outlined above.

However, if we continue to see a further upturn in the economy and with the related increase in our WIP levels, we would predict a pressure on our 2013/14 and 2014/15 budgets. The demand on our budget tends to lag slightly behind any increased economic activity so the value and timing of budgetary pressures will depend on the strength and speed of the recovery.

Prepared by: Invest NI
5 December 2012