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29 October 2024

Dear Kenneth,

Thank you for your letter of 10 September 2024 addressed to Acting Minister for Climate Action, Dr Alasdair Allan, seeking further written information on the Scottish Government's process for identifying and mitigating risks associated with contingent liabilities and for your follow-up letter on 24 September 2024. The responsibility for monitoring contingent liabilities and for assessing risks to the Scottish Government's budget sits within my Ministerial portfolio and as such I have provided my response below to the points raised in both your letters.

How the potential cumulative risks across all contingent liabilities (including their profiles) are monitored within the Scottish Government

The Scottish Government considers and monitors the cumulative risks across its portfolio of contingent liabilities on a systematic and ongoing basis. The aggregate contingent liability risk is considered through the Scottish Government's wider approach to fiscal sustainability as well as through its established assurance processes.

The Scottish Government has faced, and continues to face, a range of risks in maintaining a fiscally sustainable position over the medium-term and it follows a robust approach to identifying and monitoring these risks. This includes consideration of the key funding risks (such as block grant adjustments and net tax position) as well as the key spending risks (such as demand-led expenditure and inflation).

The cumulative risks across all contingent liabilities is assessed as part of this overall approach to risk management.

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Contingent liabilities are also monitored and assessed through our established assurance processes. These include:

- A quarterly update of a comprehensive contingent liability log to identify and challenge updates provided by policy areas on all individual contingent liabilities. This log includes consideration of gross exposure, likelihood of the contingent liability being called, profile of exposure and profile of possible expenditure if called.
- A dedicated finance business partner covering each policy area across the Scottish Government and providing challenge and support at an individual transaction level.
- An annual review of the consolidated contingent liability portfolio to underpin the annual accounts and annual updates to the Finance and Public Administration Committee ('the Committee'), together with the subsequent scrutiny and challenge from both Audit Scotland and the Committee.

The Scottish Government is confident that the processes in place to review and to provide assurance on the cumulative risk across its portfolio of contingent liabilities, as outlined above, are robust. We also recognise that the aggregate exposure of this portfolio is growing, particularly in respect of offshore renewable projects, and that it is important our approach to managing these risks evolves as our exposure increases.

As I outlined in my response to the Committee of 26 April 2024, we have been considering improvements to our current processes around the monitoring, review and reporting of contingent liabilities as well as the approval of transactions involving contingent liabilities.

I am pleased to confirm that we are establishing a Contingent Liability Group to underpin the strengthened processes. The Group will be comprised of representatives from across the Finance and Exchequer functions, bringing together the fiscal sustainability considerations and the existing assurance processes. The Group will also include contributions from legal and subsidy control experts where appropriate to the consideration of an individual transaction.

The Group will have two principal functions:

- Review a quarterly update on contingent liabilities and provide assurance to Accountable Officers on the aggregate position and its impact on balance sheet risk and fiscal sustainability.
- Advise on transactions involving contingent liabilities, including the requirement to report or seek approval from the Committee.

The strengthened reporting structures aim to provide additional assurance on aggregate exposure from contingent liabilities, the scrutiny and review of individual contingent liabilities and the audit trail underpinning both the approval of contingent liabilities and our compliance with the requirements of the Written Agreement.

The basis upon which the Scottish Government assesses the risks to its budget of both the number of and potential costs of contingent liabilities

The Scottish Government assesses the risks posed by contingent liabilities through the robust processes outlined above and we are assured that this risk remains manageable in the context of the fiscal position moving forward. There are three aspects to this assurance.

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Firstly, the processes and controls and mitigations in place at an individual project level which ensure that on an individual basis, very few present a significant exposure net of any associated mitigations and security packages. The Scottish Public Finance Manual and associated guidance is clear that in considering a transaction involving a significant contingent liability, comprehensive due diligence must be undertaken to understand the risk and available mitigations. In the cases reported to the Committee, this is almost always supported by external, specialist commercial and legal advice and independently challenged by functional areas in the Scottish Government.

Secondly, the portfolio of contingent liabilities is diversified across a range of different operators and financial institutions, such that the risk of a widespread call on contingent liabilities, particularly in a manner that crystallises multiple contingent liabilities at the same time, is considered low. While there is exposure to key renewable energy sectors, the types of market events which could trigger a widespread call on these guarantees would likely warrant a co-ordinated response across the UK.

Thirdly, even in the event of a widespread call on contingent liabilities, there are actions the Scottish Government can take to manage the impact on our in-year budget. The amount of expenditure that could be expected to be incurred in a single financial year is a fraction of the aggregate exposure and one that could be managed within the Scottish Government's overall budget envelope. This would require reprioritisation and in-year savings recognising that the financial context is increasingly challenging.

We are therefore confident that were there to be collective, concurrent failure of contingent liabilities, we would take appropriate action to manage the impact on fiscal sustainability and to minimise the risk that this posed to the Scottish Government's budgets.

What steps are available to it [Scottish Government] to respond in the event those risks increase

For the reasons outlined above, we are assured that the risk associated with our contingent liability portfolio is low and is manageable at this time. In the event this risk increased, appropriate action would be taken. This would include:

- Renegotiating or calling in security packages and exploring alternative commercial solutions.
- Re-profiling the expenditure associated with the crystallised contingent liabilities across a number of financial years.
- Reprioritising other planned expenditure to mitigate the impact on any single year.
- Co-ordinating with UK Government and other devolved administrations as appropriate to address wider market failure or intervention required.

2023-24 Annual Update

I am pleased that we continue to make progress in returning to pre-Covid 19 financial reporting and auditing timescales, with the Scottish Government's consolidated accounts for the year 2023/24 being published on 10th October 2024. In line with previous financial reporting schedules, I can confirm that we will provide the Committee with the 2023-24 annual update on contingent liabilities by the end of November 2024.

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I welcome the Committee's ongoing interest in the management of our contingent liabilities and would welcome the opportunity to discuss the 2023-24 annual update and the other matters of interest to the Committee at a future Committee meeting. I would be grateful if your officials could work with my private office to agree a suitable time for this discussion.

I trust that this update is helpful.

Yours sincerely,

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