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Dear Kenneth

ANNUAL UPDATE ON CONTINGENT LIABILITIES

The Session 5 agreement between the Scottish Government and the Finance and Constitution Committee was updated, by agreement, on March 2021 to include a commitment that the Scottish Government will provide “an update annually, normally in September, of outstanding contingent liabilities, including any costs incurred”.

The Annual Update for 2020-21 was provided in March 2022, as a result of the ongoing impact of Covid-19 on the timing of financial reporting and auditing across all sectors. As in 2020-21, the 2021-22 Scottish Government Consolidated Accounts were laid and published in December. In keeping with that timescale, the Annual Update for 2021-22 is now submitted to Committee. It is hoped that timelines will advance but this is unlikely to restore to pre-pandemic timings for 2022-23 Accounts.

The Annual Update includes information on existing Contingent Liabilities that have previously been presented to, and approved by, the Committee. The update includes details on those liabilities that are considered to be commercially sensitive and confidential. The update also includes details on matters that have been considered by the committee but have been deemed not to be commercially sensitive.

As the Committee is aware, certain contingent liabilities have been considered and approved by the Committee in private sessions or in private correspondence.

The Scottish Government remains committed to transparency as part of our Open Government Action Plan. The need for transparency is balanced against the need for commercial confidentiality in order to protect both Scottish Government, and our counterparty’s, interests and to ensure that the Scottish Government can operate as a credible party to any future transactions.

Scottish Ministers, special advisers and the Permanent Secretary are covered by the terms of the Lobbying (Scotland) Act 2016. See www.lobbying.scot



On that basis, as certain contingent liabilities remain commercially sensitive, we request that Committee respects the confidential nature of the updates provided in relation to these instances and ensures that the information is kept **strictly private and confidential**.

I hope that the Committee finds this update helpful.

Deputy First Minister

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ANNUAL UPDATE ON CONTINGENT LIABILITIES

Background

1. The authority of the Parliament is required before the Scottish Government can grant a guarantee or indemnity which would, in effect, bind the Parliament into providing future funding in the event of the guarantee or indemnity maturing. This approvals process does not apply to a guarantee or indemnity which is granted under a statutory requirement to do so or is of a standard type and arises as an unavoidable feature of an activity authorised by statute.
2. The Written Agreement between the Scottish Government and the Finance and Constitution Committee sets out:
 - the Scottish Government's undertaking to submit to the Committee in advance, any proposals to grant any guarantees or indemnities in excess of £2.5 million (including those without limit)
 - the process for the consideration by the Committee
 - an undertaking to notify the Committee of all contingent liabilities between £300,000 and £2.5 million.
3. The Committee has considered a number of such proposals and this report fulfils the requirement for the Scottish Government to provide "an update annually, normally in September, of outstanding contingent liabilities, including any costs incurred".

Specific reporting on contingent liabilities considered by the Committee

4. This report provides updates in relation to the contingent liabilities previously considered and approved by the Committee.
5. **Annex A** provides information in respect of each of the following matters considered by the Committee which are not commercially sensitive and confidential:
 - Lochaber Aluminium Smelter
 - Winchburgh Housing Development
 - UCI Cycling World Championships
6. **Annex B** provides information in respect of contingent liabilities which the Committee has considered in private and where the information remains commercially sensitive and confidential.

Reporting of Contingent Liabilities in Annual Accounts

7. The annual accounts of the Scottish Government and other bodies are prepared in accordance with the Government Financial Reporting Manual which applies International Financial Reporting Standards to the central government context.

The accounts contain:

- disclosures about contingent liabilities that meet the accounting standard definition and
 - information about other liabilities arising from indemnities and guarantees which are included for parliamentary reporting and accountability purposes (in accordance with the Scottish Public Finance Manual).
8. Note 19 to the accounts provides information on Contingent Assets and Liabilities in accordance with accounting standards (International Accounting Standard 37). **Annex C** shows the detail of the 2021-22 Accounts disclosure.
9. Note 17b provides information for parliamentary purposes on guarantees, indemnities and letters of comfort, confirming that none of the items listed there meets the definition of a contingent liability within IAS 37, because the likelihood of a transfer of economic benefits in settlement is assessed as too remote. **Annex D** provides the analysis of the 2021-22 Accounts disclosure.
10. The full accounts are available at: [The Scottish Government Consolidated Accounts for the year ended 31 March 2022 \(www.gov.scot\)](https://www.gov.scot/Information/Accounting/2022-23/2022-23-accounts) Equivalent information is available in the [accounts of prior years](#).

Additional Information - updates to the 31 March 2022 accounts position

11. The regular in-year financial management practices include reviewing any movements or expected changes to the contingent assets and liabilities, financial guarantees, letters of comfort and indemnities. A recent review was carried out in advance of the 31 March 2023 year end. In view of the elapsed time since the 2021-22 accounting period, Annex E provides some additional information on changes expected to the contingent assets and liabilities accounts log in the current financial year. These will be confirmed or amended via the accounts preparation and audit process for the 2022-23 accounts disclosures.

Annex A Update on contingent liabilities

Lochaber Aluminium Smelter

Background

In December 2016 the Scottish Government entered into a 25-year financial guarantee relating to the hydro plant and aluminium smelter at Lochaber. This involved guaranteeing the power purchase obligations of the smelter if the business does not fulfil its obligations to pay for contracted power. The guaranteed annual amounts vary between £14m and £32m over the life of the contract. The Scottish Government receives an annual fee in return for the guarantee.

The Committee approved the contingent liability on 22 November 2016.

The Scottish Government's contingent liability is protected by a series of cross-guarantees and a comprehensive security package.

The Scottish Government has security over the smelter, the Fort William hydro-electric power station and substantial land holdings in support of its guarantee. This means that in a potential default scenario, the Scottish Government would be able to utilise these assets to recover any amounts it had required to pay.

The Lochaber guarantee exposure has been assessed in line with a HM Treasury Green Book analysis, concluding that the value of the security granted to the Scottish Government exceeds the present value of the payments guaranteed.

Update

In light of the current position of the GFG Alliance group, the Scottish Government reviewed the level of provision required with regards to their guarantee as part of the 2021/22 annual accounts process. The provision in the Consolidated Accounts decreased from £161 million in 2020/21 to £114 million as at 31 March 2022. The Auditor General has confirmed the approach taken is reasonable.

There has been no call on the Government's guarantee and no public expenditure under the guarantee. All payments due under the guarantee – that is, fees to Government and PPA payments due to bondholders – are up to date.

Winchburgh Housing Development

Background

As part of the Winchburgh Housing Development there is a potential liability in relation to loan repayments for the construction of Winchburgh Primary School. The housing development is due to pay the council as houses are sold.

The Scottish Government have entered into an arrangement to cover final costs if the developer cannot pay which can be called upon after 31 March 2026.

The Committee approved the contingent liability on 13th September 2018.

Update

The current value of potential liability as per the Scottish Government's most recently published annual accounts for 2021/22 is £15m (2020/21: £15m).

There has been no call on the guarantee to date.

Union Cycliste Internationale

Background

This contingent liability is in respect of the inaugural 2023 UCI Cycling World Championships.

The 2023 UCI Cycling World Championships in Glasgow and across Scotland will bring together 13 existing UCI World Championships together for the first time to create a mega event as well as delivering key policy ambitions and acting as a catalyst for transformational change.

This is a new event that will be held every 4 years and will bring together existing world championships of 13 different cycling disciplines to be held from the 3rd to the 13th August at a range of locations across Scotland. The event will be organised and delivered by a partnership involving the Scottish Government, EventScotland, Glasgow City Council, UK Sport and British Cycling.

The rights for the Cycling World Championships are held by the international governing body of the sport, the Union Cycliste Internationale ('UCI'), based in Switzerland. On behalf of the partnership and as principal funder and underwriter of the Championships, the Scottish Government signed a Long Form Agreement which represented a contingent liability.

The contingent liability relates to circumstances whereby the UCI incurs financial loss arising from the early termination of an agreement with one or more of its commercial sponsors as a result of a material breach in the Long Form Agreement by the Scottish Government and its hosting partners. The liability would also relate to the recovery of any 'wasted expenditure' or additional costs arising from the early termination of the Long Form Agreement as a consequence of a material breach by the Scottish Government and its hosting partners. The total liability in those circumstances is capped at 13.2 million Swiss Francs.

The contingent liability was approved by the Finance Committee on 11 August 2019.

Update

There has been no call to date on the contingent liabilities contained within the Long Form Agreement to date.

Contingent Asset and Liability disclosures within 2021-22 SG Consolidated Accounts

19a. Contingent Assets disclosed under IAS 37: Provisions, Contingent Liabilities and Contingent Assets

The definition of a contingent Asset under IAS 37: Provisions, Contingent Liabilities and Contingent Assets is a possible asset, arising from past events, whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the entity's control.

NHS Employer's Liability estimated at £3m (2020-21: £2m).

Grants repayable as a result of sales of Housing Association Properties to tenants or as a result of conditions of grant being breached. Grants become repayable when conditions of grant cease to be met. It is not possible to predict the level of activity in future years.

Repayments of grant from the Open Market Shared Equity Scheme which allows people on low income to buy a share in a property, the balance being owned by a housing association and funded by grant from the Scottish Government. If the property is sold or an increased share is purchased by the owner, the grant becomes repayable. It is not possible to estimate the level of future receipts.

19b. Contingent Liabilities disclosed under IAS 37: Provisions, Contingent Liabilities and Contingent Assets

The definition of a contingent Liability under IAS 37: Provisions, Contingent Liabilities and Contingent Assets is:

- a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence of one or more uncertain future events not wholly within the entity's control; or
- a present obligation that arises from past events but is not recognised because it is not probable that a transfer of economic benefits will be required to settle the obligation; or
- the amount of the obligation cannot be measured with sufficient reliability.

Only contingent liabilities above the threshold of £2.5m, which have to be reported and authorised by the Scottish Parliament in accordance with the Scottish Public Finance Manual, are included in the consolidated annual accounts.

NHS related

Clinical and Medical compensation payments of £457m (2020-21: £394m).

NHS Employer's Liability estimated at £5m (2020-21: £4m).

Housing related

The Mortgage Indemnity New Home Scheme (MI New Home) allows credit-worthy borrowers, locked out of the market by high deposit requirements, access to 90% to 95% LTV mortgages. The scheme is supported by a SG guarantee which sits behind cash indemnities set aside by participating house builders (for each house sold under the scheme). The guarantee valued at £2m (2020-21: £7m) can only be called upon once the indemnities are exhausted and lasts for 7 years. The guarantee scheme ended for applicants in 2015, therefore the potential calls on this scheme will end in December 2022.

National Housing Trust (NHT) guarantees of £1.5m (2020-21: £4m) which the Scottish Government are committed to giving but are not active until construction has been completed. The risk of a call on the guarantee has significantly lowered with a number of developments leaving the NHT. We do not expect a call on the guarantee in the near future but we are monitoring each development closely through the Scottish Futures Trust to understand if tenants are continuing to pay their rent and thereby allow the loan debt to be serviced. This situation is subject to change.

As part of the Winchburgh Housing Development there is a potential liability in relation to loan repayments for the construction of Winchburgh Primary School. The housing development is due to pay the council as houses are sold. The Scottish Government have entered into an arrangement to cover final costs if the developer cannot pay which can be called upon after 31 March 2026. Current value of potential liability is £15m (2020-21: £15m).

Justice related

Claims against former independent Conveyancing and Executory Practitioners in Scotland. This is a contingent liability relating to an agreement to meet any valid claims arising from the acts or omissions of past independent conveyancing and executory practitioners, as defined by the Law Reform (Miscellaneous Provisions) Scotland Act 1990. The amount and timing of any outlay is uncertain.

COPFS has been subjected to several civil and damages claims. COPFS is opposing these claims but continues to review each case individually for liabilities that may arise as the legal process progresses. The value of these claims has yet to be finalised.

Rural related

The Supreme Court found that an element of the Agricultural Holdings Act 2003 breached the European Convention of Human Rights -Art 1 P1. Remedial legislation was enacted to resolve this and a small group of tenant farmers have taken SG to Court of Session seeking compensation for breach of their rights arising from the Remedial legislation. The court has issued initial judgement but litigation is still live and more court activity is required to resolve. The amount and timing of any outlay is uncertain.

EU CAP audits can result in future disallowances and a number of audits are in progress relating to CAP for scheme years 2015, 2016, 2017, 2018 and 2019. The level of late payment penalties from the EC to the UK member state and the split of penalties attributed to administrations are still to be formally concluded for CAP Pillar 1 scheme year 2015. With regard to the schemes from 2016 to 2019 the Scottish Government are in regular communication with the Rural Payments Agency over the current state of analysis and potential level of payments. However the amount and final timing of any outlay in relation to these two items is uncertain.

Benefit Underpayments

Social Security Scotland acknowledges that administrative errors by its staff (official error) and that of the Department for Work and Pensions under Agency Agreements will sometimes result in the underpayment of benefit. Where underpayments relating to official error are identified, we pay arrears in full at the earliest opportunity.

Due to limitations in data the liability for benefit underpayments cannot currently be quantified and so a contingent liability exists for underpayments not yet identified and corrected.

Redress Scotland

The Redress for Survivors (Historical Child Abuse in Care) (Scotland) Bill was passed in Parliament in March 2021 and received Royal Assent on 23 April 2021. Scotland's Redress Scheme went live in December 2021. The Act established Redress Scotland as an independent body and made provision for the functions of Redress Scotland and of Scottish Ministers in relation to the redress scheme.

Individuals who apply to the scheme complete and submit an application form, together with supporting information, to Scottish Government who review the application prior to any submission to Redress Scotland. Redress Scotland convene a panel to consider each application. The panel make decisions using the statutory assessment framework and the applicant will choose whether to accept the terms.

In relation to the applications received under Scotland's Redress Scheme up to 31 March 2022, which have not yet concluded, there is a potential maximum liability of £74million. Some of this may be covered by the contributions received from associated organisations (see note 13 Deferred Income). This would not all be payable in the next 12 months due to the time required to process each application, taking into consideration the workload of the Panel at Redress Scotland and because applicant's have a six month period to consider the offer of redress before choosing whether to accept and receive payment. A more accurate liability associated with these applications is not possible to calculate as given the nature of the scheme there is no reason to assume that the level and nature of previous applications will be a reasonable basis for future applications.

The full liability over the course of the scheme is unknown, as the total number of applications is not known and the distribution of the nature and level of individual payments awarded is not possible to predict. However the Scottish Government is committed to giving financial redress to all survivors, regardless of the financial contributions received from contributing organisations.

Decommissioning of offshore renewable energy installations

Functions under the Energy Act 2016 in relation to decommissioning offshore renewable energy installations in Scottish waters transferred to Scottish Ministers on 1st April 2017. This also means that the Scottish Government is now the funder of last resort in cases where the developers/owners cannot meet their decommissioning obligations. As the size of the Scottish portfolio of offshore energy projects grow so does the cumulative value of the decommissioning obligations and contingent liability. The value of the contingent liability to date has been reviewed in line with guidance issued by the Department of Business, Energy and Industrial Strategy entitled 'Decommissioning of offshore renewable energy installations: guidance notes for industry' published in March 2019.

The value of the contingent liability to date relates to 5 constructed and operational projects

Projects with approved decommissioning programmes and approved financial securities:

- Neart na Gaoithe Offshore Wind Farm (NNG) (Fife) (£98m)

Projects with decommissioning programmes and approved financial securities still to be approved:

- Beatrice Offshore Wind Farm (c. £100m) (constructed);
- Hywind Energy Park (Aberdeenshire) (c. £20m) (constructed);
- Aberdeen Bay Wind Farm, also known as European Offshore Wind Deployment Centre (Aberdeenshire) (c. £20m) (constructed);
- Moray East Offshore Wind Farm (Aberdeenshire) (c.£235m) (partially constructed);
- Kincardine Offshore Floating Wind Farm (Aberdeenshire) (c. £20m) (constructed)
- Seagreen Offshore Wind Farm (c. £100m) (partially constructed)

Other

The Scottish Government occupies a number of leased properties which have dilapidations clauses in the leases. These properties are maintained in excellent order, but there is a potential liability to reinstate the internal layout of these buildings to their original floor plans. These costs will be subject to negotiation and the monetary impact is not reliably estimable.

In certain circumstances (e.g. late termination of contracts) a payment of up to 13m Swiss Francs (£11m at 31 March 2022 exchange rates; £10m at 31 March 2021 exchange rates) would be due to the UCI (the Union Cycliste Internationale) in relation to the UCI Cycling World Championships to be hosted in Scotland in 2023.

As part of Transport Scotland's normal course of business, the Forestry Commission grants the right to use a forestry track as an emergency diversion route on the A83 Rest and Be Thankful on the understanding that Transport Scotland has the liability for any incidents that may occur whilst the track is being used for this purpose. The potential obligation is estimated at £5m (£2020-21: £5m) and it is considered unlikely that any liability will occur.

Guarantees, Indemnities and Letters of Comfort disclosures within 2021-22 SG Consolidated Accounts

17b. Guarantees, Indemnities and Letters of Comfort

The Scottish Government entered into the following guarantees, indemnities or provided letters of comfort. None of these is a contingent liability within the meaning of IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, since the likelihood of a transfer of economic benefit in settlement is too remote. They are included for parliamentary reporting and accountability purposes.

Only guarantees and indemnities above the threshold of £2.5m, which have to be reported and authorised by the Scottish Parliament in accordance with the written agreement between the Finance Committee and the Scottish Government, are included in the consolidated annual accounts.

Guarantees

Guarantee to Lothian Pension Fund in relation to the admission of Scottish Futures Trust Ltd, Scottish Homes Pension Fund, Scottish Legal Complaints Commission, Scottish Agricultural College and Scotland's Learning Partnership.

Guarantees for 10 local government pension schemes, as a result of Visit Scotland taking on the staff from the local area tourist boards.

Guarantee to Fife Council in relation to the admission of The Scottish Agricultural College to the LG Pension Fund.

Guarantee to Dumfries and Galloway Council in relation to the admission of The Scottish Agricultural College to the LG Pension Fund.

Guarantee to Highlands and Islands Enterprise in relation to their pension scheme.

Guarantee to Strathclyde Pension Fund in relation to admission of Scottish Canals.

Guarantees to Shetland Council Pension Fund; Orkney Islands Council Pension Scheme and Highland Pension Fund

Indemnities

At the beginning of the year there was an existing indemnity relating to objects lent under the National Heritage Act 1980 and the National Heritage (Scotland) Act 1985. The year-end balance depends on new acquisitions and the number of exhibitions that these pieces are included in during the financial year, and at 31 March this was £1,839m (2020-21: £1,277m).

Existing indemnity for local museums and galleries dependent on the number of new acquisitions and number of exhibitions that these pieces were included in during the financial year, valued at £22m (2020-21: £17m) at 31 March.