



OFFICIAL REPORT
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Public Audit and Post-legislative Scrutiny Committee

Thursday 6 October 2016

Session 5



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Thursday 6 October 2016

CONTENTS

	Col.
DECISION ON TAKING BUSINESS IN PRIVATE	1
SECTION 23 REPORTS	2
“Audit of higher education in Scottish universities”	2
“Scotland’s colleges 2016”	18
SECTION 22 REPORTS	30
“The 2014/15 audit of Edinburgh College”	30
“The 2014/15 audit of Glasgow Colleges’ Regional Board”	30

PUBLIC AUDIT AND POST-LEGISLATIVE SCRUTINY COMMITTEE
5th Meeting 2016, Session 5

CONVENER

*Jenny Marra (North East Scotland) (Lab)

DEPUTY CONVENER

*Alison Harris (Central Scotland) (Con)

COMMITTEE MEMBERS

*Colin Beattie (Midlothian North and Musselburgh) (SNP)

*Liam Kerr (North East Scotland) (Con)

*Monica Lennon (Central Scotland) (Lab)

*Alex Neil (Airdrie and Shotts) (SNP)

*Gail Ross (Caithness, Sutherland and Ross) (SNP)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Antony Clark (Audit Scotland)

Gary Devlin (Scott-Moncrieff)

Caroline Gardner (Auditor General for Scotland)

Hugh Harvie (KPMG)

Mark MacPherson (Audit Scotland)

Tricia Meldrum (Audit Scotland)

Stuart Nugent (Audit Scotland)

Kirsty Whyte (Audit Scotland)

CLERK TO THE COMMITTEE

Terry Shevlin

LOCATION

The Robert Burns Room (CR1)

Scottish Parliament

Public Audit and Post-legislative Scrutiny Committee

Thursday 6 October 2016

[The Convener opened the meeting at 09:00]

Decision on Taking Business in Private

The Convener (Jenny Marra): Good morning and welcome to the fifth meeting of the Public Audit and Post-legislative Scrutiny Committee in 2016, in the fifth session of the Scottish Parliament. I ask everyone to ensure that their mobile devices are switched off or in silent mode.

Item 1 is a decision on whether to take business in private. Does the committee agree to take items 5, 6 and 7 in private?

Members *indicated agreement.*

Section 23 Reports

“Audit of higher education in Scottish universities”

09:01

The Convener: The next item is an evidence session on the Auditor General for Scotland’s report “Audit of higher education in Scottish universities”. I welcome Caroline Gardner, the Auditor General for Scotland, and, from Audit Scotland, Antony Clark, assistant director; Tricia Meldrum, senior manager; and Kirsty Whyte, audit manager.

I invite the Auditor General to make an opening statement before I open up the session for questions from members.

Caroline Gardner (Auditor General for Scotland): Thank you, convener. The report is our first look at the overall landscape of higher education in Scotland. I will outline the context that Scottish higher education operates in, as it is a bit different from the other sectors that we audit.

As you know, the Scottish higher education sector is successful and internationally renowned. Higher education is a devolved area except for funding and policy relating to the United Kingdom research councils and Innovate UK, the UK’s innovation agency. Other aspects of UK Government policy, such as UK immigration policy and English higher education policy, affect the higher education sector in Scotland. Scottish universities generate funding from a wide range of sources, both public and private.

Although universities are independent, they operate within an environment of multiple stakeholders, regulators and accountabilities. I do not appoint their auditors, as I do for the other bodies on which I report to the Parliament, but since 2010 I have had formal powers to undertake performance audits of bodies that are funded by the Scottish Further and Higher Education Funding Council, and that is the basis of the report.

In 2014-15, the Scottish Government provided £1.1 billion in funding for universities through the Scottish funding council and £623 million in fees, grants and loans for individual students. Scotland’s economic strategy is clear about the contribution that higher education makes in supporting Scotland’s economy, but we think that the Scottish funding council needs to do more to ensure that the funding that it allocates to universities makes the maximum contribution to those national policy aims.

Overall, the sector was in good financial health in 2014-15. Total income was £3.5 billion—up 38 per cent in real terms over the past decade—the sector made a surplus of £146 million and it had reserves of £2.5 billion. Those are all large sums that you will recognise. Universities increasingly use their surpluses and reserves to fund investments in their estate and to subsidise some of their activities, particularly research.

Despite the positive overall picture, however, there is wide variation across the sector and a number of underlying risks. Income is increasingly concentrated in the ancient universities, some universities rely heavily on Scottish funding council funding, which creates risks at a time of continued pressure on public finances, and the surpluses and reserves that I mentioned are heavily concentrated in a few universities, particularly the University of Edinburgh and the University of Glasgow.

The European Union referendum result has increased uncertainty for the sector, with the possible impact on the public finances generally adding to risks to EU funding for Scottish universities and the effect on EU students and staff. The challenges facing the sector include potential further reductions in Scottish Government funding; risks to its ability to continue increasing its income from fee-paying students from the rest of the UK and outwith the EU; the need to invest in the estate; and the challenging new national targets on widening access.

Turning from universities to students, I want to highlight just two points. First, it has in recent years become more difficult for Scottish undergraduate students to gain a place at a Scottish university. That is mainly because applications have risen faster than the number of funded places available for them; since 2010, applications have increased by 23 per cent, while offers have increased by 9 per cent. We have recommended that the Scottish Government and the funding council carry out research to assess the impact of the limits on funded places on access for Scottish students.

Secondly, recent changes to student financial support increased the amount of loan funding available to all Scottish students, while the amount of funding for bursaries and grants fell. As a result, levels of student debt are increasing. Scottish students from more deprived areas continue to have higher levels of debt than students from less deprived areas, and the gap is widening.

As I have highlighted, universities, the funding council and the Government face a number of significant challenges to this very successful sector, and we recommend that they work together to address them. It is essential that the Government ensures that its approach to funding

higher education is sustainable in the medium to long term if its policy priorities are to be delivered.

My colleagues and I are, as always, happy to answer questions.

The Convener: Thank you very much, Auditor General. I invite questions from members.

Monica Lennon (Central Scotland) (Lab): Good morning. On page 46 of the report, you point out that

“Scottish students from deprived areas have higher levels of student loan debt than students from less deprived areas”;

indeed, you said the same in your opening statement. Are the costs associated with going to university and the prospect of debt presenting a barrier to school leavers from deprived areas?

Caroline Gardner: The straightforward answer is that, at the moment, we simply do not know. That is why we have recommended that the Government and the funding council carry out more research on the impact of the current approach to funding higher education to understand the effect of current policy decisions now and in the future.

I ask Tricia Meldrum to talk you through that in a bit more detail.

Tricia Meldrum (Audit Scotland): A 12-month review of the funding of student support has been going on and is due to report early next year, and we will see what the implications of that will be.

We have also had the report by the commission on widening access, which made a number of recommendations on opening up access to students from a wider range of backgrounds, particularly more deprived backgrounds. The first action in that respect will be the appointment of a commissioner for fair access, who will take forward that programme, working with the Scottish Government, the Scottish funding council and universities. Those are all issues that will be looked at in that programme of work.

Monica Lennon: I see that, in his response to the committee, Paul Johnston, the director general of learning and justice, suggests that progress on implementing the recommendations of the commission on widening access is contingent on the appointment of a commissioner for fair access. Do you agree with that assessment?

Caroline Gardner: The appointment is obviously a very important symbol of the Government's commitment to widening access and to taking forward the commission's recommendations, but it is only one of the recommendations that the commission made. So far, there has been a delay in making the appointment—I think that an announcement on

how it will be taken forward was made this week—but it is certainly not the only thing that is needed to answer the questions that we have set out about the number of places available for Scottish students and the effect of the student support system in Scotland on students from different backgrounds.

Monica Lennon: On the issue of student debt, you say on page 44 of the report:

“Scottish student debt has increased in recent years as financial support has shifted from non-repayable bursaries and grants to loans”.

Student debt levels rose by 14 per cent between 2013 and 2015 and are projected to average around £20,000 by 2019. What impact is that having on student retention rates?

Caroline Gardner: Again, the issue is not well enough understood in terms of research. We can all speculate on what the effect is, but a matter of concern is that, as we set out in exhibit 18 on page 47, students from the most deprived backgrounds are ending up with the highest levels of debt. That particular exhibit shows levels of debt from the most deprived fifth all the way through to the least deprived fifth. Students from the most deprived backgrounds are ending up with more debt at the end of their studies. The more reliance there is on debt to fund studying, the more that picture is likely to become a problem. That is why we have recommended research to explore that further.

Tricia Meldrum: The information that we have on retention rates, which is from 2013-14, shows that, overall, 8 per cent of students did not stay beyond their first year, so 92 per cent stayed beyond that. However, again, there was wide variation between universities. The University of the Highlands and Islands had the highest number of students not staying beyond their first year, with a figure of 20 per cent.

Monica Lennon: It is an important theme in the report. On page 49, the report notes that

“It will ... be difficult to achieve the national targets for widening access to higher education for students from deprived backgrounds.”

You recommend that

“The Scottish Government, SFC and universities need to work together”,

as you said in your statement. Would more funding help to meet those widening access targets?

Caroline Gardner: There is no doubt that more funding would help, because it would help to keep the number of funded places increasing at a similar rate to the increase in applications. That increase in applications seems to be the underlying cause of the growing gap. We know that the pressure on public finances is real, and

that it is likely to continue, whatever we hear in the autumn statement in November and whatever the Scottish Government's draft budget looks like after that.

As always, there are choices to be made. We are very conscious that the choices that are made about higher education sit within the Government's wider programme for government and that there are always trade-offs—that is what government is about. That is why we think that it is so important to properly understand the impact of the policy choices that have been made and to tease out any tensions or inconsistencies that there might be.

Monica Lennon: I want to pick up on funding. On page 20, in paragraph 35, you say that the Scottish funding council

“allocated £1.1 billion to universities in 2014/15, a reduction of six per cent in real terms, since 2010/11”.

You say that that “reflects reduced funding received” by the funding council from the Scottish Government. Do you feel that that level of funding is sustainable?

Caroline Gardner: That is a question for Government rather than for us. We recognise that there is pressure on the Scottish Government's budget overall. From next year, there will be significant choices to make about the use of the new financial powers, but they will not be a magic wand that will massively increase the amount available for public services across the piece.

On higher education, we are concerned that the ambitious policy commitments around widening access and the funding of student support will butt up against some of the cost pressures that universities already face as a result of their difficulty in raising income from other sources, particularly tuition fees from students from the rest of the UK and from outside Europe. It is really important that the Government and the funding council, together with universities, understand how those pressures will be faced. The committee might decide to explore that further with the funding council and the Government to see how they are developing their thinking on the way in which those challenges will be balanced in the medium to long term.

Monica Lennon: I have one final question. On 7 September at the Education and Skills Committee, Professor Andrea Nolan from Universities Scotland said that your report

“indicated quite clearly that the sector's sustainability is not being addressed. We need the funding for a sustainable sector that will recover the cost of our teaching and our research, while recognising that we are in difficult times.”—*[Official Report, Education and Skills Committee, 7 September 2016; c 26.]*

Do you agree with Professor Nolan's assessment?

Caroline Gardner: That is really the message of our report. As I said, the sector is internationally renowned and generally very successful, but it faces real pressures in relation to the funding available to it, the costs of continuing to deliver what it does and the Government's policy priorities. We have identified ways in which those tensions can be managed, which are to do with universities continuing to seek efficiencies, investing in new ways of delivering research and teaching, and working together in doing some of that.

More generally, it is for the Government and the funding council to work with universities to really understand how Government funding can have the biggest contribution to the things that the Government wants to achieve and so support the sector, which is one of Scotland's strengths.

Monica Lennon: Thank you.

09:15

Colin Beattie (Midlothian North and Musselburgh) (SNP): To pick up on Monica Lennon's point about the debt levels of students from deprived areas versus those from less deprived areas, would you not expect that students from deprived areas would have a higher level of debt simply because they qualify for access to the funding to a greater extent than students from less deprived areas and because they have the need for it?

Caroline Gardner: Intuitively, that makes sense; it is certainly a pattern that we see more widely than just in Scotland. The issue is the one that Ms Lennon asked about—whether we understand the impact of that on students applying to Scottish universities and taking up places. There is not good enough information about that part of the mix. In England, there is good evidence that higher levels of loan funding for higher education are not deterring students from applying. We simply do not know what the picture is in Scotland at the moment, and having that picture would help to make good policy decisions.

Colin Beattie: Will you follow up on that in due course?

Caroline Gardner: We have recommended that the Government and the funding council should do that, and we will certainly follow up on our recommendation with them once the committee has finished its deliberations on the report.

Colin Beattie: Have your recommendations been accepted by the various parties?

Caroline Gardner: The committee has written to the funding council's director general and chief executive. You have submissions on the issues before you today. The Government's response to

that point is slightly ambiguous; it might be something that you want to follow up with the Government after the session.

Colin Beattie: You have talked about research and development. Various parts of the sector have concerns about that area. Will you keep an eye on the issue and follow up on it? Only in time to come will we understand the impact of Brexit.

Caroline Gardner: Our concern is that the Scottish funding council's strategy for research and funding research in universities is somewhat out of date. It has not been revised for a while, and that needs to happen in order for the funding council to be clear that its funding is having the effect that it needs to have. We know that there are challenges with the research funding that is available from other sources not covering the full costs of research.

I will ask Kirsty Whyte to talk you through the issue.

Kirsty Whyte (Audit Scotland): We know that the funding council is starting to review its approach to research. We identify in the report that Scottish universities' performance on research is improving. Between 2008 and 2014, the annual exercises that assess how well universities do research, if you will, show that improvement. However, at the same time, the research funding has not got any bigger, which means that the research budget has been spread more thinly, and some of the very high-performing research universities saw a reduction in their research funding after the 2014 exercise. As we say in the report, that raises issues around sustainability.

As the Auditor General mentioned, research is traditionally an activity in universities that does not cover its costs. Last year, universities recovered about 80 per cent of the full economic cost. The amount that they recover depends on the source: some universities that win a lot of charity funding recover only about 65 per cent of the full economic cost of those activities, while the proportion increases to more than 80 per cent for the UK research council funding. As the Auditor General said, that places additional pressure on universities and raises sustainability issues.

Colin Beattie: A point that comes up all the way through the report concerns the SFC and how it handles funding and various other things. Is there a problem with how the SFC handles matters?

Caroline Gardner: We have said in our report on universities and in our report on further education, which appears a bit later on the committee's agenda, that the funding council's role has changed significantly over the past few years—in both sectors, there have been major reforms to how funding is allocated and to the responsibilities that the funding council carries out.

However, its role has not been reviewed for at least 10 years. In the light of that and of some of the problems, particularly in further education, that this committee has looked at, we have made a recommendation that the Government should look again at the funding council's role and make sure that it is clear and that the council is properly equipped to carry it out. The Government is progressing that as part of the current review of the skills and enterprise agencies.

Colin Beattie: The commercial operations of the universities, which are fairly extensive and lucrative, are not gone into in any great detail—the report does not go into great depth on that issue. Have you looked at it to any great degree?

Caroline Gardner: There is an exhibit in the report, which one of the team will point me to in just a moment, that shows the sources of income for different universities. You are right: they vary hugely.

Exhibit 11 on page 34 of the report shows income profile by university. Members will see that some of the 18 institutions that we looked at have a very heavy reliance on Scottish funding council grants—those institutions are at the bottom of the exhibit. More than 80 per cent of the income of the University of the Highlands and Islands comes from Scottish funding council grants. The figure goes right down to less than 20 per cent for the University of St Andrews. The other income that the universities receive is from a range of different sources.

Obviously, the more that universities rely on public funding, the greater the risk that puts them in at a time when public funding is under pressure, as it is across the UK and in Scotland currently in respect of funding council grants, tuition fees and UK research councils' research funding. We have not looked directly at universities' success in generating commercial income, but it is very clear that they have had very differing levels of success and differing approaches to generating income outwith what they get from the funding council and in student support. That highlights our concern that, although the sector as a whole is in reasonable financial health, some universities are much more at risk than others in the current climate.

Colin Beattie: On exhibit 11, given the value of the commercial element to the universities, would there be merit in taking a closer look at that?

Caroline Gardner: There certainly would be. I think that the universities themselves pay a great deal of attention to that. They have different assets, sources of expertise and capacities to generate commercial income. That is one of the reasons why we have recommended that the funding council should take a closer and more

transparent interest in the financial health of individual institutions. We think that that is not well enough understood outside the universities and that that approach could lead to better funding strategies by the funding council, or to better identification of opportunities for collaboration between universities or with other parts of the public sector and business, for example.

Colin Beattie: Does the success—or otherwise—in the commercial sector of the universities compare well with the success of universities south of the border or elsewhere?

Caroline Gardner: It depends very much on which universities you are talking about. Kirsty Whyte might be able to give you some insight into that.

Kirsty Whyte: We have not looked at that in a lot of detail, but universities in Scotland and in the rest of UK, particularly in England, are focusing on the innovation agenda, the further commercialisation of research activities and company spin-offs. We know that Scotland overall is quite successful in spin-offs per head, if you will, in the higher education sector compared with the rest of the UK, but the funding council, the Government and the universities are working on that, and they could certainly look at it further.

Liam Kerr (North East Scotland) (Con): Before I get to what I want to ask, I would like to follow up on that point. Are you aware of any studies in that respect? It seems to me that the sector delivers a much wider benefit to the economy than simply producing graduates. What, aside from putting students through university, is or appears to be the wider return on investment?

Caroline Gardner: On page 11 of the report, we reference a study that was commissioned by Universities Scotland from the economic consultancy Biggar Economics. It estimated that the contribution was around £7.2 billion, which is obviously quite a favourable return compared with the £2 billion or so—£1.1 billion plus £600 million—of direct Scottish Government investment in universities. It is clear that there is always some judgment to be made in that respect, but that will give members a feel for the economic benefits. All of us who live in university cities recognise the wider benefits that come from the liveliness and openness that universities bring.

Liam Kerr: I enjoyed reading the report—I thought that it was very good, as usual. Although the sector is operating in what is clearly a very challenging environment, it continues to produce extraordinary results, and that should be acknowledged and commended. However, have you been able to draw any conclusion on the outcomes or long-term scenario if nothing were to change in relation to the funding? In order to meet

challenges, the various institutions might, for example, sell off some of their estate, seek fee-paying students or use the reserves that you mentioned, but I would not have thought that that would have been sustainable for any length of time. At some point, an institution will have sold off all the estate that it can sell off. What would be the outcome if nothing were to change?

Caroline Gardner: I will ask Antony Clark to respond in a moment, but our concern is that there are very different groupings within the 19 institutions referred to in the report. The four ancient universities are, for a range of reasons, more successful in bringing in a wider range of funding. As they tend to be the places that build up surpluses, they have reserves available for investment, and they are more likely to be able to get into a virtuous spiral of being able to invest and to build their success from there.

The universities that are much more reliant on Government funding, particularly at a time when that funding is constrained right across the Government's budget, tend to be the ones that have fewer opportunities to generate income from other sources, so they run the risk of the kind of vicious circle that you have highlighted in your question. That is not by any means a foregone conclusion, but it indicates what the risks are unless the Government and the funding council, together with the universities, are able to understand the interplay between their various priorities and ensure that the public funding that goes in achieves the maximum contribution to both the Government's policy aims and the sustainability of individual institutions.

Antony, do you want to comment?

Antony Clark (Audit Scotland): Yes. The report highlights the fact that although we talk about "the sector", it is, in a way, not a sector but a range of different institutions that serve different audiences, have different markets and provide different services that deliver different outcomes. We think of universities as being involved in higher education, but they do different things for different people.

The report highlights a series of risks that face the sector collectively, but it is clear that the institutions need to think through what market they want to be in and how they might grow or retrench in the face of the challenges from Brexit and the financial pressures on the public sector. We are very aware from our fieldwork that institutions are quite alert to that. For example, they have business planning processes in place as well as oversight boards for principals and boards. However, there is a role nationally for an overview of how the institutions work collectively to support their economic goals and the broader learning

outcomes that are set out in the Scottish Government's strategy.

Liam Kerr: I assume that, if a university sought to commercialise itself further by bringing in fee-paying students, it would have to provide courses that attracted those students, which would be to the detriment of courses that did not. Is there an issue in that regard?

Antony Clark: It is not possible for me to answer that question, but it is clear that institutions that have a good reputation in the UK and internationally are likely to draw in fee-paying students. They clearly want to position themselves as bodies that have particular skills. There is probably something in what you have said, but I am not sure that the evidence that we have gathered confirms it one way or the other.

Liam Kerr: Sure.

Tricia Meldrum talked about the research on Scottish students. Concerns are frequently raised with me that very good Scottish students are unable to get a place at universities in Scotland because the cap has been hit. Do you have a comment on that? Have you found out anything about it?

Tricia Meldrum: We have laid out information and data on that in the report. As the Auditor General said in her opening remarks, we found that the number of applications from students has been increasing faster than the number of places that are funded. Working through the data, we managed to identify the number of people who did not get a place at all through the process.

We set that information out in paragraph 95 on page 41 of the report. In the most recent year for which the information is available, almost 9,000 applicants—potential students—did not receive any offers at all, which is about one in five of those who applied. There is no information available about what subsequently happened to those people, so we do not know whether they got a place at a college or whether they worked for a while and then reapplied to university. Therefore, we have recommended that there be more research to enable us to understand what is happening and how the limit on the number of funded places is impacting on different groups of applicants and applicants from different backgrounds.

09:30

Alex Neil (Airdrie and Shotts) (SNP): My question follows on from what Liam Kerr was asking about. If there is a differential between the increase in the number of places and the increase in the number of applications, what would be the order of magnitude of the additional cost of

bringing the increase in the number of available places up to the same growth level as the increase in the number of applications?

Caroline Gardner: That is a difficult question to answer. The commission on widening access looked at that and made some estimates, but it made some other recommendations about balancing demand and the available funding by, for example, making the Scottish degree programme shorter so that it cost less by comparison—in other words, getting more student funding for the same amount of money—and making articulation more straightforward so that students could do some of their studying in further education institutions and then carry on into higher education. It is for the Government and the funding council to think through both the impact of the number of funded places and the related issue of widening access to enable students from more deprived backgrounds to come through.

Tricia Meldrum might be able to give you some figures from the commission's work. It is not simply a matter of the amount of funding per extra student that you include in funded places.

Tricia Meldrum: I am sorry, but I do not have those figures. I can say, though, that the commission makes the point that because this is a whole-system issue that starts in the early years and continues through school, college and university, you cannot fix it, as it were, just in universities. It is a matter of planning across the whole system.

Alex Neil: That is true for some things. However, the capacity—the number of places—is not a whole-system issue; it is surely a decision based on the availability of resources. I accept that getting a higher percentage of kids from poorer backgrounds into universities will require a whole-system approach that probably needs to start even earlier than primary education, but funding capacity to keep pace with the increase in the number of applications has nothing to do with primary education. It is a resource issue. Everything else being equal, if we had to close the gap by providing additional money, what would be the order of magnitude of the cost of closing the gap?

Caroline Gardner: I ask Kirsty Whyte to address that question.

Kirsty Whyte: I must apologise—we have not done that calculation, but we are happy to get back to the committee on the issue. The easy option would be to multiply the amount of grant funding by the additional demand; however, it is not quite so simple to work out the level of funding, because it depends on where demand is directed. Some courses such as medicine will be much more expensive than, say, social sciences

courses. The calculation is complicated—it is not an easy one.

Alex Neil: I am not suggesting that it is easy; I just wondered whether you knew the order of magnitude of the funding that it would take to close the gap. It would be useful if you were able to give us an indication of what the funding gap is.

Secondly, have you looked at productivity in the university sector? I think that the issue merits investigation.

Caroline Gardner: Not in this audit. As you will recognise, the audit covers quite a lot of ground, and we were keen to keep it manageable.

The funding council requires universities to generate efficiency savings as part of their conditions of grant. In recent years, those savings have been at the 3 per cent level but, if we look further at the recommendation from the commission on widening access, there must be scope to reconsider the organisation and funding of teaching and research, the extent of collaboration across universities and the range of things that would come under productivity, efficiency and what we get for the money that we spend.

Alex Neil: Do we have too many universities in Scotland?

Caroline Gardner: That is not a question that I can answer.

Alex Neil: That was a nice way out.

Brexit means that, at some point in the next five or so years, EU students will not get free education in Scotland; their doing so has been a consequence of the abolition of tuition fees. We want to maintain a cosmopolitan and internationalist approach to recruiting students to come to Scotland. At the moment, we fund EU students to come to Scottish universities. How much does that cost the Scottish Government?

Caroline Gardner: One of my colleagues will in a moment be able to give me a figure for the number of EU students funded by the Scottish Government. Before that, though, I should flag up the point that it is not entirely a one-way bet; the universities are concerned that they get a significant and disproportionate share of EU research funding that comes into Scotland. Moreover, because of that, many research and teaching staff come from the EU, and there is a concern about losing them.

Alex Neil: The Scottish Parliament information centre briefing on EU funding indicates that our money gets recycled in Europe and then comes back to us and that, when we take everything including the common agricultural policy into account, we still have a notional surplus of about

£800 million a year. The funding for that is available if we repatriate the EU funding to the Scottish Parliament for our notional share, but that is not the case with the funding for EU students.

I do not want fewer students from Europe. The more students we have from Europe and the rest of the world, the better it is for the education system, our economy and our society. However, I am interested in the round figure of how much we spend on providing free higher education to EU students.

Caroline Gardner: I think that Tricia Meldrum has tracked the figure down for you.

Tricia Meldrum: I have the numbers for students. In 2014-15, there were 20,805 EU students and 29,000 students from other countries outwith the EU.

Alex Neil: What share of the budget is spent on EU students who get free higher education here?

The Convener: I think that Kirsty Whyte has the answer to that.

Kirsty Whyte: In 2014-15, the Government spent just under £25 million on tuition fees for EU students.

Alison Harris (Central Scotland) (Con): I, too, enjoyed what I thought was a valuable report. I am delighted and proud that the Scottish higher education sector is doing so well and is internationally renowned, but your statement that the

“financial position masks underlying risks”

rings alarm bells for me. I understand that it is spread between the older universities and the new universities but if we do not address the situation now, we face a potential crisis in five or 10 years’ time. Do you have any more thoughts on that or do we need to take that back to the Government and the SFC?

Caroline Gardner: We have tried to capture our thoughts in the recommendations. The sector has real strengths—it is one of the things of which Scotland can be most proud—and there are challenges that it to some extent faces as a whole but which are really focused on particular universities that do not have access to the same range of income as others.

Part of the challenge is to understand how the Government’s different policy priorities—free tuition for all Scottish students, widening access for students from more deprived backgrounds and continuing to fund world-class research—interplay in the sector as a whole and in individual institutions. That is important, as is understanding the impact of decisions about student support and tuition fees on the decisions that Scottish students and potential students make about where they

want to apply to. We have tried to capture that in the recommendations. It is not an easy fix, but sitting down now, understanding how those things interact with each other and thinking through how the nearly £2 billion every year can be spent to the best effect seem exactly the right things to do.

Alison Harris: And if we do not get it right, we face a potential disaster.

Caroline Gardner: There are certainly risks to the sector and particularly to some institutions.

The Convener: I have a couple of questions about capital funding. We know that students are attracted to universities for multiple reasons, one of which is obviously good facilities. Therefore, the reduction of 69 per cent in capital funding seems absolutely huge—although it is trumped by the 77 per cent reduction in capital funding for colleges, as mentioned in the report that we are about to look at. Are there any other parts of the public sector in Scotland in which there has been such a huge reduction in capital funding?

Caroline Gardner: I will ask colleagues whether they have any comparative figures; if not, we might be able to come back to the committee with that information.

It is important to note that the capital funding element of the Scottish Government’s budget, which over the past few years has been very largely funded through the block grant, has taken a significant hit and, indeed, has been hit to a greater extent than revenue funding. Exhibit 12 in the report shows that the drop in funding body grants has been counteracted, to an extent, by an increase in universities’ use of internal funds—in other words, surpluses and reserves—and an increase in borrowing and loan funding, particularly over the past few years.

We absolutely recognise how important that is. Universities need to make sure that their estate continues to be fit for purpose with regard to not only teaching but research, which often brings with it particular needs, because it enables them to attract staff and students and therefore affects their long-term sustainability. It therefore seems to us that that is a key issue, which is why we focus on the importance of the Scottish Further and Higher Education Funding Council’s having a clear strategy for how it will allocate that capital funding to the universities over the medium term.

The Convener: You mentioned surpluses, but I think that we know that there are certain universities that have healthy surpluses and universities that do not. The University of Dundee, for example, is currently running a deficit. From the point of view of equity across higher education, how does that affect the quality of different universities? Is there not an inequity there?

Caroline Gardner: That is another illustration of the variability across the whole sector. We know that Edinburgh and Glasgow universities account for a large part of the reserves that are available across Scotland. I think that the overall figure is £2.5 billion, a large amount of which belongs to those two ancient universities.

As I said in response to Liam Kerr, there is a danger that, while the successful universities will be able to invest in and build on their success, those with a greater reliance on public funding will find it more difficult to invest in that way, so there is a risk that they will decline. The availability of funds is a key part of the long-term sustainability of individual institutions.

The Convener: Sticking with sustainability, I want to go back to Liam Kerr's important point about the economic impact of universities. As parliamentarians, we are all acutely aware of that; indeed, we and Government ministers often trumpet the fact that we have so many universities in the top 100 in the world. How will the reduction in research funding impact on our universities' economic impact and their standing in the world?

Caroline Gardner: Research success is key to both those things. I will ask Kirsty Whyte to talk through what is happening with the different streams of research funding, because it is not just the Scotland Government funding that is provided through the Scottish funding council that has an impact in that respect.

Kirsty Whyte: Indeed. As I mentioned earlier, universities have traditionally struggled to recover the full economic cost of research activity. Many funding streams are deliberately designed in such a way that they do not provide 100 per cent of the funding that is required for the activity in question. There is an in-built element of efficiency, in an effort to make universities deliver efficiencies, but a tight research budget and funding package place pressure on universities' ability to generate surpluses elsewhere in their activities to cover those costs, as the Auditor General has said.

09:45

The University of Dundee was mentioned earlier. It is successful in generating research income, but a lot of that comes from charity sources, which makes it difficult for it to continue to cover its costs. Similarly, the fact that research council and industry funding is not 100 per cent funding continues to place additional pressure on universities in generating surpluses and making efficiencies in order to be able to continue their research output.

The Convener: If universities continue to attract good amounts of research funding but the Scottish funding council cannot cover the 20 per cent gap,

is there a risk of some research going by the wayside, with an effect on the research standing of our universities?

Kirsty Whyte: It is really up to universities how they want to position themselves and what financial strategies they develop to address that. Universities will consider their own research profiles and identify where they can create surpluses and how they can attract alternative incomes, including, for example, recruiting more students from non-EU countries.

The SFC also has a role to play. In our report, we recommend that it look across the sector at the risks and the information available in order to identify the challenges.

The Convener: As members have no further questions, I suspend the meeting in order to change witnesses. Thank you all very much.

09:46

Meeting suspended.

09:47

On resuming—

“Scotland's colleges 2016”

The Convener: Item 3 on our agenda is an evidence-taking session on the Auditor General's report entitled, “Scotland's colleges 2016”. The Auditor General is joined by Mark MacPherson, the senior manager of Audit Scotland; and Stuart Nugent, the audit manager.

The Auditor General will make an opening statement.

Caroline Gardner: Scotland's colleges have been through a period of major change, which I have reported on previously. Today's report provides an update on progress on implementing and managing those changes, including the impact on students and staff. It also comments on the sector's financial position, and the role of the Scottish funding council.

Although the merger process is now complete, colleges are continuing to adjust to changes, including regionalisation, reclassification as public bodies, and new funding and monitoring arrangements. Against that backdrop, the sector continues to exceed national targets for the provision of learning.

However, the Scottish Government is still not able to fully measure the benefits and costs of its merger programme. Since some measures, such as student destinations and employer engagement, lack baseline information, it will now be very difficult for the Government to

demonstrate whether its reforms have delivered all the expected benefits.

Scotland now operates with 13 college regions, three of which contain more than one college. Only one of the three regional bodies was able to perform the role that was expected of it in 2014-15 and 2015-16.

There is a mixed picture in terms of student participation. The number of people under the age of 25 in full-time college education has increased by 14 per cent over the past 10 years. Over the same period, the total number of students has fallen by 41 per cent, and the number of part-time students has fallen by 48 per cent. Most of the reductions have been among women and people aged over 25. It is not possible to determine whether those reductions reflect a fall in demand, as data is not collated at national level.

The overall percentage of full-time further education students successfully completing their course increased year-on-year between 2009-10 and 2013-14, but dropped slightly in 2014-15. Colleges told us that the amount of change in the sector, along with efforts to widen access to students from more deprived areas, contributed to the reduction.

Information on destinations for college students was published for the first time this year. That showed that, in 2013-14, at least 82 per cent of students went on to education, training or employment.

Staff numbers fell by 9 per cent between 2011-12 and 2013-14, before increasing by 5 per cent in 2014-15. Staff feedback on the impact of mergers is mixed. Some felt that mergers had been successful, and cited benefits from sharing best practice and offering more opportunities for development, while others had concerns about the impact on workloads of voluntary severance and the reduced number of support staff.

The sector's financial position deteriorated in 2014-15. Although the overall financial health of the sector is relatively stable, we identified four colleges that face financial challenges. Colleges do not have long-term financial plans that would help them prepare for further financial pressures, such as national collective bargaining, estate maintenance and student support funding.

I have reported previously on significant governance failings in a small number of colleges. The college good governance task group has published its recommendations, which should mitigate the risk of significant governance failures in future.

As you would expect, the SFC undertakes regular monitoring of colleges. That has improved over time, but it has not always resulted in timely

and effective resolution of problems. We found that the Scottish Government had not undertaken a comprehensive review of the SFC's role in the past 10 years, and we recommend that one take place.

My colleagues and I are happy to answer the committee's questions.

Colin Beattie: I am contrasting the responses that we have received from the SFC and from the Scottish Government. The SFC's response seems very clear—it indicates straightforwardly whether the SFC agrees with the various recommendations. However, I am less clear about the response from the Scottish Government.

Caroline Gardner: I had the same reaction when I read the response from the Scottish Government. I think that you would need to direct that question to the Government.

Colin Beattie: It is possibly something that the committee will want to take up.

Page 26 of your report lists some key messages about college finances and says that the Scottish Government's approach to funding colleges for depreciation is complex. Could you explain what is complex about that issue?

Caroline Gardner: I knew that you would want to drill into that issue.

Depreciation is not complex to accountants and people who understand it—I acknowledge that that does not cover many people in the world. It is a straightforward way of recognising the fact that fixed assets deteriorate in value over time and that there is a cost to that.

The way in which depreciation has been funded in colleges in the past has been unusual, and the change to colleges being classified as public bodies has added to the complexity. Stuart Nugent will talk you through that.

Stuart Nugent (Audit Scotland): Prior to being reclassified, colleges were provided with cash funding to cover all elements of cost, including depreciation. As depreciation was not a cash spend, colleges were free to save that money and put it towards the reserves, or spend it. If they spent it, that would result in a deficit.

Following reclassification, colleges can no longer apply that money to their reserves. They can still spend that money but, if they do, it will result in a deficit, as before. However, the Scottish Government has approved certain items of expenditure that that money can be spent on, such as student support payments, repayment of loans and issues around specific regional pressures. If the cash that was set aside for depreciation was spent on those items, that would result in a technical deficit, which the Government would

understand and accept as such and would not view as a normal operating deficit. That is the difference between the situation before and after reclassification.

Colin Beattie: That makes things a bit odd. What is the total value of the money that we are talking about?

Stuart Nugent: The total value in 2014-15, including the repayments of loan debt, was £17 million.

Colin Beattie: That is not a small sum for the colleges.

I want to ask about an issue that we have discussed before: arm's-length foundations, or ALFs. What are colleges doing with them now? I know that when they were set up, colleges moved initial funding into the ALFs to avoid losing it. Are they still putting money into them? Have you looked at ALFs at all?

Caroline Gardner: Yes, we looked at them as part of our review of the 2014-15 accounts. Mark MacPherson will talk you through the changes that we have seen this year.

Mark MacPherson (Audit Scotland): Colleges are still transferring money into ALFs—I think that the figure for 2014-15 was £7 million. As far as we can determine, ALFs are operating as intended; colleges are paying in money, making applications and, in most cases, getting the money back. Colleges might have their applications refused—indeed, that has happened with a few colleges—and other bodies can apply to the ALFs for money, provided that it is for the intended purposes of further education. That, too, has happened in a few cases.

Colin Beattie: Where did the £7 million come from?

Mark MacPherson: Colleges can still generate surpluses and, at a certain point in the year, they will make an estimate of how much they think they might be able to transfer into the ALF for, I guess you could say, safe keeping—if it can be guaranteed that they will get it back.

Colin Beattie: So they are putting public funds into the ALFs.

Mark MacPherson: Colleges can generate their own income, of course, so—

Colin Beattie: But it is still public money, even if it comes from commercial operations.

Mark MacPherson: I think that it depends on how the colleges have generated it. Presumably, if they can fund whatever it is they have been paid to deliver from commercial income, that is within their—

Colin Beattie: I think that that is more than just a grey area. As they are public institutions, any income that they generate becomes public income.

Caroline Gardner: As we discussed with the committee in the previous session in relation to Coatbridge College, colleges generally are not able to account for their funding as being public or private. There is a good deal of allocation of costs between different headings, and colleges are accountable for the funding that they receive from the funding council. I think that the overall management of their budgets is a matter of proper public interest and interest to this committee.

Colin Beattie: Is the amount of funds in the ALFs increasing?

Mark MacPherson: I think that it decreased over the period since last year. Colleges made a large transfer in the first year that they existed, because they had reserves that they were able to transfer. Now that they are operating on a year-to-year basis, the amounts that they are able to transfer are smaller. As we say in the report with regard to capital funding, it is clear that they have to rely on some of the money sitting in the ALFs to pay for some of the changes that they want to implement. I expect that, over time, the funds in ALFs will reduce.

Colin Beattie: But Audit Scotland will keep an eye on the matter.

Caroline Gardner: Absolutely.

Colin Beattie: The other issue that keeps coming up in these reports is the Scottish funding council. For example, on page 35, you say:

“The SFC’s role in regulating college governance is not clear and”

as we have seen

“it has not been effective in ... some issues”.

Are there any indications that it is getting better?

Caroline Gardner: As we say in the report and as I said in my opening statement, we think that the funding council has got more effective at monitoring what is happening in colleges. It is not always clear that its monitoring has led to the resolution of problems instead of simply identifying them; indeed, we saw a good example of that in Coatbridge College. However, it is also true that the funding council’s role has expanded markedly over the past few years, with big changes in both the council itself and the further and higher education sectors for which it is responsible. That is why I have recommended that the Government review its role and how well equipped it is to carry it out.

Colin Beattie: Might there be a conflict of interest with the SFC increasingly becoming a regulator as well as the organisation that dispenses funding?

Caroline Gardner: I do not think so. Colleges and indeed higher education institutions are accountable to the funding council for the money that it distributes on behalf of the Government. It does not seem to me to be a conflict of interest that the funding council is monitoring their financial health and how well they are fulfilling the funding conditions. However, as I have said in the report on colleges and the report on higher education, I think that there is room for the funding council to do that in a more strategic way.

Monica Lennon: Last year, you recommended that the Government and the funding council publish financial information on the costs of and savings achieved through the merger process. On page 12 of your report, you say that many of the costs of the merger, such as the costs of harmonising pay, were not included in the SFC's assessments. What other factors have been omitted from those calculations?

10:00

Caroline Gardner: The funding council has now published its summary of the costs and benefits of the merger programme. We think that there are two broad areas for which it does not provide the full information that we would expect to see. The first of those areas, as you have identified, is the full cost of the mergers, particularly the cost of harmonising terms and conditions across the colleges that have merged, which is potentially quite significant.

The second area is the benefits that the mergers were intended to achieve. There is some good information and examples of colleges working better after merger, but there is no baseline information on some important questions. My team will keep me straight, but I think that, for students, there are the questions of their destinations and their satisfaction with their studies and, for employers, there are the measures of employer engagement. The evaluation says that there are improvements in employer engagement but there is no baseline to compare that with. Without that full picture, it is hard to be clear what the full costs were and whether the intended benefits have been achieved.

Monica Lennon: In the absence of that baseline, it is not possible to establish whether the estimated £50 million of savings has been achieved.

Caroline Gardner: It is difficult to be clear about whether the full benefits have been achieved and

the full costs have not been captured. The evaluation takes account of the amount of money that the funding council provided directly to colleges to support mergers, but we know that colleges incurred costs in significant areas such as harmonising the terms and conditions of their staff. That information has not been captured and played into the evaluation.

Monica Lennon: Will it be possible to fully capture all that information or is it too late to go back and get that baseline?

Caroline Gardner: That is a good question, and why we have been recommending it for the past couple of years. In some ways, it should be possible to go back and calculate the cost information although the further out we get, the more difficult that becomes. At this point, it would be difficult to go back and generate baseline information that was not collected in the first place.

We have been reporting on reform programmes across the public sector for a while and we have been clear from the start about the need to have good baselines so that we can see what has changed as a result. That did not happen in this case and it will be difficult to go back and generate that baseline information.

Monica Lennon: Does that mean that it will be difficult to provide evidence that the original aims of the process have been fully achieved?

Caroline Gardner: The further that we get from the point of merger, the more difficult it gets.

Monica Lennon: Thank you. You report big falls in certain subject areas as a result of cuts in part-time places. Exhibit 4 on page 19 illustrates that very well. We see that courses such as computing and health have fallen by almost half, which is quite significant, and in your statement, you talked about the reduction in the number of part-time students and the gender dimension whereby 53 per cent of the decrease is women.

Looking at the courses in exhibit 4, what is the impact of the cuts on those subjects? Is there a vocational aspect to the courses? Do we know what students are doing now to acquire the skills that they would perhaps have obtained through those courses?

Caroline Gardner: Stuart Nugent will come in on that in a moment. It is worth saying initially that, to a great extent, the changes reflect the Government's policy decision to focus funding on full-time courses that were likely to lead to a qualification that would lead to employment, therefore directly vocational courses are likely to be gaining.

One of our concerns was that a full assessment was not done of that change and the funding council's later funding change and what they

meant for students. We do not have enough of an overall picture of demand for further education to know what is happening to the students who were displaced by the process.

Stuart Nugent: One of our recommendations is that the funding council should look to assess the demand for college places, which would allow us to answer the question of what has happened to the students who no longer attend college. Are they still applying? There is currently no national picture of demand for college places across the country. Individual colleges have their own information systems but there is not a national picture, so we made our recommendation in light of that.

Liam Kerr: I have a quick follow-up to Monica Lennon's question. You talk about student numbers decreasing, particularly among women and people aged over 25, but you said in your statement that the data is not collated at national level. Are you able to say categorically why those reductions have happened?

Caroline Gardner: From paragraph 28 onwards, we talk about the policy changes that led to those reductions. In 2009, the Scottish Government asked the funding council to focus its funding on the courses that were most likely to lead to employment, which led to less funding for courses that did not lead to a recognised qualification or which were less than 10 hours in duration. That is an entirely appropriate policy choice for a Government to make—it is what Governments are for. Further, a shift in the way in which the funding is allocated through into the funding policy has had an impact on the way in which students are counted. We think that that is what is behind the reductions.

Our concern is that the Government did not carry out an impact assessment, in advance, of what was likely to happen to the people who were not able to gain places in further education as a result of the changes. As Stuart Nugent said, information on demand for FE courses is not collected across Scotland. Although individual colleges have their own information, they do not know whether a student who they turned down for a place went to a college elsewhere, so we do not have the overall picture. It is not clear whether people simply moved somewhere else or were unable to access further education that they would have been able to access before the policy change was introduced.

The Convener: Turning to the recommendations in the report, you have said that the Scottish Government and the Scottish funding council should work with colleges to determine the current condition of the college estate and prepare a plan to ensure that it is fit for purpose. Is there a

concern that the college estate across Scotland is not fit for purpose?

Mark MacPherson: We just do not have the data. In the report, we talk about some work that the Scottish funding council has undertaken to try to assess the areas in which there has been less investment but, as our recommendation suggests, we need to make a proper analysis across the piece. I am sure that, at individual college level, many colleges will have made an assessment of their own estate, but that needs to be brought together to allow any funding decisions to be made on the basis of solid evidence.

The Convener: Was your concern about the college estate driven by the 77 per cent reduction in capital funding for colleges?

Mark MacPherson: We do not necessarily have a specific concern about the college estate. Our concern was that, when limited capital investment is available, you need to make best use of it. If no one has a clear picture of the overall state of the estate throughout the country, it might be difficult to allocate funding that becomes available.

The Convener: In response to my question in the previous agenda item, you explained why there has been a reduction in capital spending. Have any other public sector bodies in Scotland experienced such a huge reduction—77 per cent—in capital spend?

Caroline Gardner: As we said earlier, we will come back to the committee with any detailed comparisons that we can provide. However, we know that the Scottish Government's overall capital departmental expenditure limits budget reduced more significantly than its revenue budget did over the period since 2010. Different public bodies have different ways of compensating for that. At the moment, councils are really the only bodies that can borrow, and they have used that to continue investing in their capital assets over the last period. Other bodies have not had the same ability to do that.

There has been some investment in the college estate through things such as public-private partnerships. However, as Mark MacPherson said, we do not have a clear picture, as we have for the national health service, for example, where there is a regular condition survey that gives the assurance that the estate is fit for purpose or estimates how much investment will be needed to bring it up to an acceptable condition.

The Convener: I notice on page 26 that the Scottish Government is now looking to PPP to mitigate some of those capital funding cuts in future. Do you think that its plan of £300 million will be sufficient or is it hard to say?

Caroline Gardner: At the moment, we just do not know. Without that regular condition survey, it is difficult to be clear what is needed. At the moment, the plans are centred on public-private partnerships because that is the only way that the Government has had to complement its capital allocation through the block grant. From next year, there will be new borrowing powers for the Scottish Government under the Scotland Act 2016, but all of that has long-term revenue consequences, so the Government and the funding council need to be clear across the budget of where the priorities are for investment and what the long-term effect is of “paying that back.”

The Convener: I am interested in that, because the Government always tells us that it has moved away completely from PPP but, from the report, that is clearly not the case.

You talked about the 41 per cent reduction in overall student numbers and, from the graph in exhibit 9, it is clear that overall funding to the college sector has reduced—it seems to have reduced to the tune of £150 million since 2009-10. Given that reduction in spending and the reduction in the number of students, is it fair to say that the college sector has taken a huge cut?

Caroline Gardner: The reduction in funding to the college sector has been very significant. Obviously, it is more significant than the reductions in the health service and local government. The Government has had to respond to a very significant reduction in the budget that it has had available since 2010 because of the direct relationship between the UK Government's budget and the block grant that funds Scottish Government services. Choices have to be made on that. There is a question for Government, looking backwards, about how it has made the decisions on allocation and, looking forward to future budget discussions, how it will make those decisions.

It is also important to note that the reduction in funding has reflected a shift in policy, which Mr Kerr asked about earlier. There has been a reduction in the number of students but a significant increase in the number of full-time students coming through of 14 per cent over the same period.

The Convener: You said earlier that, although there has been a reduction of 41 per cent in the number of students, you do not have the data to show a reduction in demand. Locally, over the years, I have seen information on numbers of applications. Why is that not collected? Surely, in relation to funding places at college, it would be a priority for Government to have a clear idea of how many young people, or just people, want to go to college? Why is that information not collected?

Caroline Gardner: We think that it is really important that it is collected. As you say, individual colleges know how many applications they receive, how many offers they make and how many students accept those offers. However, if they do not make an offer or a person does not accept an offer, they do not know whether that person is doing nothing or is moving to another college to take the same course or a different course. We have that information for higher education in Scotland and we think that it is important that we have it for further education, because of the shift in policy and because of the increasing recognition that the link between school, college and higher education is important in allowing people to fulfil their potential, however well they do in the early years.

The Convener: Is it one of your recommendations that the Government needs to collect information on applications?

Caroline Gardner: Yes, it is.

The Convener: So it is quite possible that hundreds if not thousands of students want to go to college but cannot, but we just do not know.

Caroline Gardner: It is possible, but we do not know. It is equally possible that those students have accessed further education in a different college, perhaps doing the course that they wanted or a second preference. It is possible that they have gone into employment of some sort. Without collecting that information across Scotland, we do not know. That seems to us the key thing that the funding council should resolve with colleges as a matter of urgency.

The Convener: If the higher education sector has collected that data for so long, why has the further education sector not done so?

Caroline Gardner: There is a system to do it across Scotland for higher education, but there has not been a system for colleges. In the past, colleges have been seen much more as local institutions and the way in which the funding has worked for students has meant that the issue has not had the same priority. However, it now clearly has that priority, for all the reasons that we have discussed this morning.

The Convener: Do members have any further questions?

Alex Neil: I have a couple of questions. Obviously, the thrust of the policy change was to get a closer alignment between college courses and employment. The latest available figure shows that 82 per cent of leavers from college had a positive destination. How does that compare to the same figure in 2009, when the new policy was introduced?

Caroline Gardner: The information was published for the first time for 2013-14. I think that we saw a very slight reduction between 2013-14 and 2014-15. It is not clear what the reasons for that reduction were, but that is obviously an early warning that colleges and the funding council should pay attention to ensure that the policy is having the desired effect.

Alex Neil: So we do not know what the destination figure was before the policy was changed.

Caroline Gardner: The first time that the information was published was for 2013-14.

Alex Neil: Okay. The other figure that strikes me is the drop-out rate. The figure for those staying on improved from 59 to 64 per cent, although it slipped back a wee bit last year. However, even in the best year, there was still a 36 per cent drop-out rate, which is very wasteful, is it not? Why is the drop-out rate so high and what can we do to reduce it?

Caroline Gardner: We have not had the chance to look at that in detail yet. We have heard from colleges that the changes that were going on in the system and the attempts to widen access for students might both be contributing to that. That is one reason why having the data is so important and why colleges and the funding council should be exploring what is happening across Scotland and in individual colleges so that we can reverse the trend. As you say, it is not good for students and it is not a good use of the public money that Government is spending in the area. Addressing that has to be a priority.

Alex Neil: I would have thought so.

The Convener: I thank our witnesses very much for their evidence.

I suspend the meeting briefly before we take the next item.

10:16

Meeting suspended.

10:20

On resuming—

Section 22 Reports

“The 2014/15 audit of Edinburgh College”

“The 2014/15 audit of Glasgow Colleges’ Regional Board”

The Convener: Item 4 is two section 22 reports on Edinburgh College and the Glasgow Colleges Regional Board. The Auditor General is joined by Mark Roberts and Mark MacPherson, senior managers at Audit Scotland; Hugh Harvie, partner at KPMG; and Gary Devlin, partner at Scott-Moncrieff.

I invite the Auditor General to make her opening statement, which will cover both audits, before I open up to questions from members.

Caroline Gardner: Thank you, convener. I am briefing the committee on two reports that I have prepared under section 22 of the Public Finance and Accountability (Scotland) Act 2000. The first of those is a report on the 2014-15 audit of Edinburgh College.

Edinburgh College was formed in October 2012 by the merger of Jewel and Esk College, Telford College and Stevenson College. Although the auditor gave an unqualified opinion on Edinburgh College’s financial statements for 2014-15, his annual report highlighted that the college had experienced financial difficulties at the end of that financial year. That was the result of the college failing to meet its activity targets for 2014-15 and it led to the Scottish funding council seeking to recover £800,000 from the college in November 2015.

Following confirmation from the funding council that it was seeking to recover funds, the principal initiated a detailed review to understand better the reasons for the failure to meet the target. The review highlighted a number of underlying problems, including issues with student recruitment and retention. The findings led to the college negotiating a 6 per cent reduction in its 2015-16 activity target, with an associated reduction in funding. The college’s scope to reduce its fixed costs was limited and the funding reduction led to a funding gap of £2.5 million for that year. That placed the college in severe financial difficulty.

My report on Edinburgh College was laid in Parliament in March this year. Since then, the college has developed a transformation plan to address the issues that were identified in the principal’s review. The funding council has agreed

to provide transitional funding support to help the college to implement the plan.

The plan envisages that the college will return to a surplus in 2018-19. I have asked the auditor to monitor developments and to report on progress as part of the annual audit and I will report again early in 2017.

Alongside me is Hugh Harvie from KPMG, who is the auditor for Edinburgh College, and Mark MacPherson, a senior manager with Audit Scotland. With your permission, convener, I will pause there and we will answer questions about that report and then I will introduce the Glasgow Colleges Regional Board report separately, as the two reports cover quite different issues.

The Convener: Thank you.

Colin Beattie: The report that we have in front of us is fairly brief. I realise that it came from the audit of Edinburgh College rather than an Audit Scotland intervention as such, but I for one would have appreciated a bit more information about how the situation came about and a bit more on the timelines. Anecdotally, I am told that it happened under previous management. I cannot really tell from the report whether that is the case. Are there any plans to do a more detailed investigation?

Caroline Gardner: We can certainly provide you with more information in answer to your questions this morning and, as I said, I will report again on progress with this particular case. It is fair to say that the problems came to light quite late in the financial year under audit. That timeline has limited the extent to which it has been possible to report on the history of what has happened. Hugh Harvie might want to say something more about what has come to light about the problem since it was identified at the end of the 2014-15 financial year.

Hugh Harvie (KPMG): The main issue that has arisen is the college's ability to meet its liabilities as they fall due, to put it simply. The activity levels upon which the college is funded had fallen below those which were forecast and, as a result, the funding that it was able to claim from the Scottish funding council was reduced. The college still had a large cost base that supported a higher level of activity and, as a result of the reduced funding and having too high a cost base, there are issues in the look-forward period.

Colin Beattie: I recognise from the report that the problem is from the college failing to deliver the agreed activity. What are the reasons for that? What led up to that? How did it get into that state? Did it happen gradually or overnight? Did it go wrong in one particular year? There are a lot of questions.

Caroline Gardner: There are, and I recognise that the report is brief. That reflects the way in which the problem came to light, which was as a result of a grant claim from the funding council.

The core of the issue is a shift in the funding council's funding priorities. In the past, colleges have been able to claim for activity almost regardless of which students the activity related to. There was a widespread practice called additionality, which meant that colleges could claim funding for a student who was meeting the full-time minimum requirements, but could also claim additional funding for delivering additional learning to that student. As part of the policy to ensure that the funding was achieving the best impact and equipping as many students as possible to move into employment, the funding council removed the ability to fund additionality. Instead, more students had to be recruited and retained to generate the same level of funding.

The newly formed Edinburgh College did not understand the extent to which it relied on funding through additionality to cover its cost base. As the merger worked through and the information came to light, it became clear that there was a problem of about £800,000 relating to grant funding for 2014-15, and further investigation showed that there would be a much bigger problem in the future, which the college and the funding council have tried to work together to resolve. It is an emerging picture for the college, the funding council and for us, which is why the report that was laid in March is quite high level. We have done work since then to explore the issue and I will report on it again early in 2017.

Colin Beattie: Given the nature of the problem, is it possible that other colleges might have the same difficulty and that that has not come to light yet?

Caroline Gardner: The same question occurred to us, as you would expect. I will ask Mark MacPherson to talk you through what we have done in that area.

Mark MacPherson: From discussions with the funding council, we are aware that Edinburgh College was not the only college that used additionality. The use of additionality has not been outlawed as such, but a limit has been placed on it to encourage colleges to focus on individual students and additional students, instead of additional activity. We do not have the data to hand to see how widespread the practice might be in other colleges, but we understand that Edinburgh College was an outlier regarding the amount of additionality that it was using to bolster its activity.

Colin Beattie: Did the SFC do any assessment of the risk involved with such a fundamental

change to the way that business was being conducted, and the possible impact on colleges, including Edinburgh College?

Caroline Gardner: You would have to ask the SFC that question. We understand the policy basis for the shift, but the extent to which it carried out a full assessment of the risks associated with that shift is not something that we can answer to the committee's satisfaction.

Colin Beattie: That was a decision by the SFC, not the Scottish Government—or did the decision come from the Scottish Government?

Caroline Gardner: I think that it was a decision made by the funding council in 2014 that relates to the Government's policy priority of focusing funding to help as many students as possible to gain qualifications that will help them into employment. It links back to the increasing focus on full-time students, rather than part-time students, and on courses that lead to a qualification.

Colin Beattie: It was the SFC that interpreted it in that way and sought to implement policy by making that change.

Caroline Gardner: That is my understanding.

Liam Kerr: I want to be absolutely clear on that point, as Colin Beattie raised some valid concerns. There was a college in financial difficulty and there was a move to recover £800,000 due to additionality, which better prepares the students for the workplace.

You said in your answer to Colin Beattie that that policy shift happened because colleges are trying to recruit more students in order to get the funding. In other words, we are trying to put more students through the system rather than better prepare for the workplace the students that we have, which is why there is now a problem. Was that policy decision taken by the Scottish Government or the Scottish funding council? In any event, is recouping that £800,000 really what the SFC should be doing in the circumstances?

10:30

Caroline Gardner: There are a lot of questions in there.

Liam Kerr: Forgive me.

Caroline Gardner: I will make a start, then ask Mark MacPherson to come in.

The starting point is what we discussed earlier in relation to my other report. In 2009, the Government asked the funding council to focus its funding on courses that were most likely to lead to employment, which led to less funding for courses that did not lead to a qualification and less funding

for shorter courses. The policy was one of the drivers behind the increase in the number of full-time students and the reduction in the number of part-time students over that period.

In 2014, the Scottish funding council introduced new guidance to ensure that colleges place an emphasis on increasing the number of students that they recruit rather than on the amount of learning that the students that they have already recruited experience or benefit from. There was therefore a move away from the previous practice of recruiting students who met the minimum requirements for full-time study and providing those students with more learning and receiving more funding for it; instead, the focus was on recruiting more students who each met the full-time minimum threshold.

During the merger process, Edinburgh College did not fully understand the impact of that change on its funding model, but it became clear towards the end of the 2014-15 financial year that it was at risk of overclaiming funding from the funding council under the old model. When the college thought that through, it recognised the impact on its funding for future use, which gave it a much bigger funding gap that needed to be filled. The college has been working with the funding council to understand that and manage its financial implications. It is one of those misunderstood policy changes, but it has had a particular impact on Edinburgh College that cannot easily be undone in a single financial year. Do you want to add to that, Mark?

Mark MacPherson: Yes. I have a couple of points. I emphasise again that the additionality that we talk about is a legitimate activity and use of funding, and the funding council has not said that colleges should not do it. However, I think that the funding council wants to understand very clearly why colleges are doing it and whether it might be at the expense of giving other students an opportunity to participate in learning and gain a qualification.

Mr Kerr also asked about the £800,000. Hugh Harvie can correct me if I am wrong about this, but the current situation is that the funding council has not recovered the £800,000 and has decided to allow the college to retain it in order to implement parts of its transformation plan. It is very important to emphasise that the college still has a difficult period ahead of it and a lot of work to do, and the funding council and Audit Scotland will be keeping a close eye on that.

Liam Kerr: Are you able to tell us what learning is being captured out of the situation to ensure that it does not happen again? Clearly, it is not impossible that there will be similar institutional movements in the future. How do we ensure that

what happened does not happen again? Who will take forward the learning from this situation?

Mark MacPherson: I do not think that we are entirely well-sighted, as the Auditor General mentioned, with regard to what consultation or engagement took place with the sector before the policy change was made. I am pretty sure that the funding council will have acknowledged that and that other colleges that in the past might have made use of, and relied on, additionality will be looking closely at their own circumstances to understand how that worked. I would see it as a role for the funding council and colleges to reflect on the learning from what happened with Edinburgh College.

Liam Kerr: Thank you for that, but I am referring to the learning from the situation in general, not just that from the additionality. What is being done to ensure that the general learning outcomes from the process of addressing the situation at Edinburgh will mean that it will not happen the next time that there is such a merger?

Caroline Gardner: In general terms, we have taken two points from it that we are trying to play through our reports on the college sector as a whole. The first is that reform programmes, particularly those involving mergers, are times of higher risk when things can go wrong, whether that is people misunderstanding their funding models or problems around voluntary severance and letting staff go with redundancy packages. We have seen problems in all those areas and we have reported previously that the funding council could have done more to help and support colleges through that process.

The second point relates specifically to the policy change in 2009. As I said earlier, we do not think that the funding council did enough work to understand fully the potential impact of changing policy—however appropriate and well-intentioned the change is—towards focusing on getting people into employment. At the same time, it is important to understand the impact on other people affected by the policy. The same is true here.

Both points underlie our recommendations to the Government, and particularly to the funding council, about reviewing the funding council's role, what it is expected to do and how well it is equipped to carry out that role.

Alison Harris: If I have picked up your figures correctly, you have said that the college did not have money and that it would not meet its liabilities but that, by 2018-19, it will be in surplus. That is quite a quick turnaround in only two financial years.

Caroline Gardner: I will start off, and Hugh Harvie might want add to what I say. Our sense is that the college has responded to the problem

quickly and thoroughly. As soon as the problem was identified, the principal, who is relatively new, initiated a wide-ranging review to understand what had happened and to make sure that the problem was fully understood. The college has engaged with the funding council to agree a short-term funding solution to get it through, and it has in place a transformation plan that it expects to return it to surplus by 2018-19. I, too, think that that is ambitious. I hope that the college can do it, but an awful lot is required to do it over that timescale.

Hugh Harvie, as the appointed auditor, will keep a close eye on progress, and I will report back to the committee at the end of each audit to bring the committee up to speed with how well the plan is going. I hope that will be to tell you that it is being successful but, equally, if there are problems, I will make sure that the committee is aware of them.

Hugh, do you want add anything?

Hugh Harvie: The costs are higher during the transformation plan, because the costs of voluntary severance are part of that plan. Indeed, those costs are inevitable when trying to reduce an organisation's cost base. Once the additional costs are incurred, the savings identified should get the college back to surplus.

Alison Harris: That is good. The college is on the case.

Hugh Harvie: Very much so.

Alison Harris: Good. Thank you.

Alex Neil: I want to clarify a couple of matters. I take the point that the funding council had not consulted on the matter, but I presume that once it had taken the decision, it informed the colleges of the policy change. What was the time gap between the funding council informing the colleges of the policy change through guidance and the college realising that it was engaging in practice that was no longer acceptable?

Caroline Gardner: The time gap was relatively short. The new guidance was introduced in June 2014 and the problem arose towards the end of the 2014-15 financial year, as the college was finalising its funding claim to the funding council.

Mark MacPherson: That is right. I do not think that there was a particularly big time gap between the formal guidance being issued and the college embarking on its next academic year. What is a bit unclear is how much consultation and notification there was in advance of the formal change being introduced.

Alex Neil: I accept the point about consultation. Clearly, a lesson is that the SFC needs to consult before it makes a decision on such matters. You are saying that, once it made its decision, it was a

short time between the SFC's new guidance coming out and the college realising that it had to change its practice. If the timeframe was so short, why is so much money involved?

Caroline Gardner: Edinburgh College is a big college—it is one of the largest in Scotland. For the initial year, the amount was £800,000. That sum of money is significant but not huge. It is when you roll up that to a full academic year and look ahead that you get to the £2.5 million gap, which is what we have here.

Alex Neil: I presume that the college stopped the practice more or less whenever it realised its mistake, did it not?

Caroline Gardner: I am sorry, but I missed the beginning of that question, Mr Neil.

Alex Neil: When the college realised its mistake, did it not very quickly stop the practice of additionality?

Caroline Gardner: It is quite difficult to stop an activity in the middle of a financial year, when students had been recruited to courses in a particular way.

Alex Neil: I think that Mark MacPherson said that the issue was discovered near the end of the financial year. I want to be clear on what you are saying, because something does not quite add up in my mind. I think that you said that the colleges were notified of the SFC decision in June.

Caroline Gardner: Yes.

Alex Neil: I presume that the college financial year is from April to the end of March.

Mark MacPherson: It goes to the end of July.

Alex Neil: So the college was notified in June—

Mark MacPherson: That was for the subsequent year.

Alex Neil: That was before the start of the new financial year.

Mark MacPherson: Yes.

Alex Neil: But the issue was not picked up until near the end of the financial year.

Mark MacPherson: Discussions were going on between the college and the SFC at various points, as they normally do between individual colleges and the SFC, to monitor performance and progress towards meeting the activity targets that had been agreed. At various times of the year, the college operated in the belief that all the activity that it was going to deliver would be eligible for funding from the SFC. Only when the final checks were conducted towards the end of the year did it become apparent that a proportion of the activity that the college expected to claim for and had

delivered would not be eligible for SFC funding. That then triggered the SFC's—

Alex Neil: There were prior checks during the financial year but nobody picked up the discrepancy.

Mark MacPherson: At that stage, the checks are based on activity at a particular point in time, but activity runs throughout the financial year.

Alex Neil: But they are still checks.

Mark MacPherson: I do not know the level of detail of the checks at that point. They are subject to—

Alex Neil: Who does the checks—the college or the auditor?

Mark MacPherson: It is usually the internal auditor.

Hugh Harvie: It is the college's internal auditor. The college has internal monitoring systems and the internal auditor carries out a check on the claim at the end of the financial year.

Alex Neil: Is one of the lessons to be learned that, in the future, the internal auditor should be much more thorough and actually check that the college is following the guidance that is issued by the SFC?

Hugh Harvie: That would require the internal auditor to carry out its work throughout the year, but I understand that it is engaged at the end of the year, as the claims are submitted.

Alex Neil: Is there not a lesson to be learned about internal management of the audit function? I presume that, had a more robust internal audit function been operating, the chances are that the issue would have been picked up at a much earlier stage.

Caroline Gardner: I think that there is a lesson about the college's overall system for making sure that it manages its finances properly. You are absolutely right that the college needs to have a system of ensuring that the assumptions that it has made about the funding that it will receive from the funding council and other sources are rolling up during the year as expected and that the funding is being properly claimed. Edinburgh College chooses to have its internal audit do that check at the year end, and there is a strong argument that colleges that have such complex sets of income streams should have audit systems that are robust enough to pick up problems during the year as they arise.

Alex Neil: The problems surely would have been picked up much earlier in any robust audit system.

Caroline Gardner: It depends on what the internal auditors are asked to do. I expect that, in this case, the internal auditor is a firm that is appointed by the college to do a specific task, with the college remaining responsible for the quality of its internal controls and system of assurance. It sounds as though that system may need to be reviewed to ensure that it is fit for purpose.

Alex Neil: The external auditor that the college employed would surely have checked the guidance from the SFC as part of its work.

Caroline Gardner: Hugh Harvie made a point about the timing of that check. If the auditor is asked to do a final check before submission, it may pick up problems too late for any adjustment to be made to the college's income and expenditure projections.

Alex Neil: But is it not a basic rule to check that the income that is expected fits in with the guidance that is provided by the substantially main funder?

Caroline Gardner: It is, absolutely. I agree with you.

Alex Neil: I think that the auditor has something to answer for as well, does it not?

Caroline Gardner: I do not know the detail of how Edinburgh College organises its internal audit, but in any organisation the internal audit is there to support the management and the board by providing assurance about the governance systems that they have in place. In this case, it sounds as though the governance system, of which the internal audit is a part, did not operate as well as it needed to.

Alex Neil: So the lesson is to improve the internal audit.

Caroline Gardner: Yes. It is to improve the internal audit as part of the system of internal controls and assurance, I think.

Alex Neil: Because it failed.

Caroline Gardner: Yes. I think that the system of internal controls and assurance failed.

Alex Neil: I do not think that we can blame it all on the funding council.

The Convener: Are there any further questions on the Edinburgh College report?

Colin Beattie: Most businesses of any size do not have a snapshot audit at the end of the year; they have an on-going audit through the year, which makes the year-end audit a great deal easier and quicker. Typically, the auditors provide an update every quarter or so. Is that not common in the public sector?

Caroline Gardner: Absolutely. It is common among the auditors that I appoint. The work will normally take place in at least two chunks. Some work will be done during the financial year, which looks at the systems for controlling expenditure and risk and the process of financial management, and a shorter financial statements audit will be done after the year-end, which produces the audit opinion that I use when I report to the committee when that is needed.

However, that is not necessarily the case for internal audit. Normally, an internal audit plan is approved by the audit committee at the beginning of the financial year, which will contain six, seven or eight internal audits that are phased throughout the year and that report back as they are completed.

There is an important difference between internal audit and external audit, which I tried to explain earlier. Internal audit is responsible to those who are charged with governance—management and the board—and provides assurance internally about controls, whereas external audit is responsible for providing assurance to me as the Auditor General and to the committee about the financial statements and the wider governance. Internal audit and external audit have different roles. In this case, it might be that internal audit has failed, but I do not think that we can draw that conclusion from the work that we have done so far.

It is clear to me that the system by which the college understood its likely income and expenditure did not pick up the change early enough, which led to a funding gap at the end of the year.

10:45

Colin Beattie: You say that, when you appoint auditors, you have them carry out an on-going audit process. Is it common among the colleges for just a snapshot to be taken at the end of the year?

Caroline Gardner: No. Hugh Harvie can tell you how he goes about the audit of Edinburgh College. I appoint him as the external auditor and he takes the approach that I described. Hugh, do you want to provide a bit more detail on that?

Hugh Harvie: We have communication and interaction with the college throughout the year on a quarterly basis. In general, the process involves us looking at the internal management accounts that are prepared and preparing questions to ask management, but it would take us a week or two to get into the level of detail that would allow us to answer the question about the funding issues, and we do not have that much time during the year to

do that. That is what we do in our role as external auditors.

To expand on what the Auditor General said, the internal auditors will do what they are directed to do by those who are charged with governance. Should management decide that they want to take a closer look at the level of funding throughout the year, they will direct the internal auditors to do that. It is not within the internal auditors' remit to always look at those areas. In effect, they will do as they are asked.

Colin Beattie: So you do a quarterly update with Edinburgh College and you ask questions about any issues that might arise. You do that according to a fixed programme.

Hugh Harvie: Yes.

Colin Beattie: Would you not ask about any changes that would impact on the college's funding?

Hugh Harvie: We would ask about how funding was going during the year and whether there were any issues with student recruitment that were driving the underlying numbers, but we would not necessarily get into that level of detail.

Colin Beattie: Would you expect Edinburgh College's internal auditors to supply you with information?

Hugh Harvie: If they were directed in that way, we would look to them and work with them so that we could leverage the work that they had done.

However, the issue arose in the context of the work that we carry out following the year end. As the Auditor General has pointed out, my role is to report on the robustness of the information that supports the numbers in the year-end accounts. We became aware of the issue, so our role was to ensure that it was appropriately reflected in the accounts.

Colin Beattie: So internal audit did not pick it up; you, as the external auditor, picked it up at the year end.

Hugh Harvie: No. We were told of it when we were carrying out our work at the year end. Our role was to ensure that the information that we were told was appropriately reflected in the accounts, which it was.

Colin Beattie: Was that the first indication that you had of the fact that there was an issue?

Hugh Harvie: Yes.

Alex Neil: Who told you about the issue?

Hugh Harvie: We were told about it by the director of finance.

Alex Neil: Not by internal audit?

Hugh Harvie: No.

Alex Neil: Whose responsibility was it to follow the SFC's guidance in the first place? Was it the director of finance's?

Hugh Harvie: Yes, it was the responsibility of the director of finance and the management team in the organisation.

Alex Neil: The director of finance should have read the guidance and followed it.

Hugh Harvie: The director of finance would be responsible for understanding the guidance. Those who record the students in the curriculum and the activity against them provide the information that allows the claim to be pulled together.

Alex Neil: I understand that, but there is guidance. To paraphrase, the SFC issued an instruction that additionality could not be applied from then on. I take it that you are saying that the financial controller or director of finance in the college was responsible for ensuring that, from that day forward, no assumption was made about getting additionality income in and that the SFC was not invoiced for additionality, as it was no longer claimable. Is that right?

Hugh Harvie: Yes, that is my view.

Alex Neil: So has the director of finance been disciplined?

Hugh Harvie: No.

Alex Neil: Some £800,000 of public money has gone down the Swanee and nobody has been disciplined. Why has nobody been disciplined?

Caroline Gardner: I think that that is a question for the college rather than for us.

Alex Neil: Should you as the Auditor General not comment on that?

Caroline Gardner: As I said in my report, the principal has carried out a wide-ranging review to look at what happened and the impact on the college's financial position in future, and to put in place a transformation plan for the college. I cannot comment on the individual responsibilities for that. My responsibility is to highlight to the committee the impact of the failure that took place in this case and the wider lessons that might come from it.

Alex Neil: There is a pattern. We discussed a similar issue last week. Large amounts of public money are being wasted as a result of incompetence, but nobody seems to take responsibility and nobody gets disciplined. If £800,000 was lost in the private sector, the person would be sacked if that was his or her responsibility. Some £800,000 of public money

has gone down the Swanee because somebody did not do their job properly. That is not good enough.

Hugh Harvie: As Mark MacPherson mentioned, the investigation is still on-going. It is unfair to point the finger at the director of finance, because nobody knows who was to blame, if there was one person to blame.

Alex Neil: It is about responsibility. You are the auditor, I asked you a question, and I am taking this from you. You said that he was responsible. He has to implement the policy. As we would expect in any corporate body, the finance director has to implement new guidance on what is and is not claimable. Maybe somebody whom he employed was supposed to check those things. Obviously, the college is big, and he cannot individually check everything. However, yet again a lot of public money has gone down the Swanee, and it appears that nobody has taken responsibility for that.

There are a finance director, a finance department, internal auditors and external auditors. The issue was not picked up among you until the tail end of the financial year and, as a result, £800,000 was lost.

Caroline Gardner: I am not here to apologise for the college or the funding council, but the case is a bit different from others that I have reported on to the committee in the past in which, for example, voluntary severance resulted in payments to individuals that were higher than was justified, and money was lost to the public purse. In this case, funding has not been claimed from the funding council. It was not available from the funding council for learning activity that had been delivered. Therefore, the money was not lost to the public purse; rather, there is a funding gap for Edinburgh College.

I recognise that that is a fine distinction, but it is important to be clear about that for the record.

Alex Neil: Fair enough, but it is clear that £800,000 is not an insignificant amount of money.

Caroline Gardner: I would not disagree with you at all.

Alex Neil: If we look at the total fees for the internal auditor, the external auditor and the finance department, we would, I presume, expect there to have been a fairly substantial amount of money between them to have got the matter sorted.

Caroline Gardner: External audit has done its job in this case. The management of the college—those charged with its governance—are responsible for having systems in place that prevent such things from happening. It is clear that those systems failed in this instance.

Alex Neil: Absolutely.

Caroline Gardner: That is why I have reported to the committee.

The Convener: We can maybe take that up with those people.

Auditor General, are you satisfied with the Scottish funding council's response and Edinburgh College's response to the Edinburgh College report?

Caroline Gardner: It is early to say that. We have said that the college has a transformation plan in place. There is a funding plan in place to cover the college's funding gap through to 2018-19. In a sense, the proof of the pudding will be in the eating and the progress that is made with the transformation plan. I will be in a better position to comment at the end of the 2015-16 audit, when I will report to the committee on the position.

The Convener: Okay. Are there any questions on the report on Glasgow Colleges Regional Board?

Colin Beattie: The report is in some ways historical, but I would like reassurance that all the issues that came out in it have been fully dealt with and that Audit Scotland is satisfied that the Glasgow colleges are where they should be.

Caroline Gardner: I ask Gary Devlin to pick that up.

Gary Devlin (Scott-Moncrieff): The issues have not all been fully dealt with, but the majority of them have been. For example, all the measures mentioned in paragraph 8 of the section 22 report—for instance, risk management frameworks, an internal audit function, key committees operating effectively and an approved scheme of financial delegation—are in place, but the draft financial memorandum between Glasgow Colleges Regional Board and the assigned colleges has yet to be finalised. Also, the Scottish funding council—probably reasonably—wants to observe how GCRB and the assigned colleges work together over a reasonable time to determine how the relationship is developing before it releases funds.

Most of the building blocks that we asked for in the section 22 report are now in place or just about to be finalised. We are at the final stages of the process.

Colin Beattie: Would it be correct to say that the governance, internal audit and process are sufficient to assure us that no public funds are at risk at this point?

Gary Devlin: In the main, yes, although the final judgment of that rests largely with the Scottish funding council and concerns the point at which it is assured that it can grant operational fundable

body status to GCRB. Great progress has been made over the past 12 months on putting those building blocks in place and the measures are now working. Some of them have been put in place more recently than others, so a bit of time is needed to ensure that those processes operate effectively.

Colin Beattie: Is it because there are still some concerns that the date of 1 August 2016 for granting operational fundable body status, which is given in paragraph 22 of the report, has been pushed back into January?

Gary Devlin: It is for the funding council to explain how it arrived at that position. GCRB, which is the body for which I am the external auditor, has been working hard in partnership with the funding council and those relationships are much improved. They have worked together on the programme to ensure that the building blocks of governance are fully in place. As I said, they are largely in place now.

Colin Beattie: A date was given in the report. I would be interested to know why it was not adhered to and what caused the slippage. The report was done in March and, in that time, August was the date at which the status was to be granted.

Caroline Gardner: Our understanding as of today—it is only our understanding—is that, as Gary Devlin said, the funding council would like to see how the relationships between the regional body and the three colleges play out in practice, given the history, and that it expects the status to be in place by January.

Colin Beattie: Okay. Thank you.

The Convener: There are no further questions. If the Auditor General does not want to make any other remarks, I thank her and her officials for their evidence.

10:58

Meeting continued in private until 11:30.

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