



OFFICIAL REPORT
AITHISG OIFIGEIL

Public Audit and Post-legislative Scrutiny Committee

Thursday 18 May 2017

Session 5



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PUBLIC AUDIT AND POST-LEGISLATIVE SCRUTINY COMMITTEE
13th Meeting 2017, Session 5

CONVENER

*Jackie Baillie (Dumbarton) (Lab) (Acting Convener)
Jenny Marra (North East Scotland) (Lab)

DEPUTY CONVENER

*Liam Kerr (North East Scotland) (Con)

COMMITTEE MEMBERS

*Colin Beattie (Midlothian North and Musselburgh) (SNP)
*Willie Coffey (Kilmarnock and Irvine Valley) (SNP)
*Monica Lennon (Central Scotland) (Lab)
*Alex Neil (Airdrie and Shotts) (SNP)
*Ross Thomson (North East Scotland) (Con)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Caroline Gardner (Auditor General for Scotland)
Hugh Harvie (KPMG)
Michael Lavender (Scott-Moncrieff)
Anne MacDonald (Audit Scotland)
Mark MacPherson (Audit Scotland)
Dharshi Santhakumaran (Audit Scotland)

CLERK TO THE COMMITTEE

Terry Shevlin

LOCATION

The James Clerk Maxwell Room (CR4)

Scottish Parliament

Public Audit and Post-legislative Scrutiny Committee

Thursday 18 May 2017

[The Convener opened the meeting at 09:00]

Decision on Taking Business in Private

The Acting Convener (Jackie Baillie): Good morning, and welcome to the 13th meeting in 2017 of the Public Audit and Post-legislative Scrutiny Committee. I ask everybody to ensure that they have their electronic devices switched off or at least on silent mode so that they do not interfere with the meeting.

Under agenda item 1, does the committee agree to take item 3 in private?

Members indicated agreement.

Section 22 Reports

“The 2015/16 audit of Edinburgh College”

“The 2015/16 audit of Lews Castle College”

“The 2015/16 audit of Moray College”

09:01

The Acting Convener: At item 2, the committee will take oral evidence on three reports from the Auditor General for Scotland. This business was scheduled for last week's meeting, but unfortunately we ran out of time. I apologise to all the witnesses if that caused them any inconvenience, and I thank them for rescheduling their diaries to be here today.

I welcome Caroline Gardner, the Auditor General for Scotland; Hugh Harvie, who is a partner at KPMG; Michael Lavender, who is an audit manager at Scott-Moncrieff; and Dharshi Santhakumaran, Mark MacPherson and Anne MacDonald from Audit Scotland. The Auditor General's opening statement will cover all three reports. I invite her to address the meeting.

Caroline Gardner (Auditor General for Scotland): Thank you, convener. As you said, I am presenting three reports on colleges, which accounts for the number of witnesses who are before the committee to help us to answer your questions as thoroughly as we can.

All three reports raise matters of public interest arising from the audits of the colleges' financial statements. I have prepared the reports under section 22 of the Public Finance and Accountability (Scotland) Act 2000, which is the vehicle for me to bring such matters to the Parliament's attention.

The external auditors gave unqualified audit opinions on the 2015-16 accounts of all three colleges, but they highlighted concerns about financial sustainability at each of them.

I begin with Edinburgh College. As the committee knows, this is the second report that I have prepared on Edinburgh College's financial position. In my previous report, I highlighted issues arising from the college's failure to meet its student activity target, and concluded that the college would face significant difficulties without further financial support. Since then, the committee has taken evidence from both the college and its auditors.

The auditor, KPMG, highlighted that the college has continued to face significant financial challenges. The college reported a deficit of £7

million for 2015-16 and relied on additional support from the Scottish Further and Higher Education Funding Council in order to meet its liabilities.

As I reported last year, a review by the principal found that the college had long-standing problems with its curriculum and with recruiting and retaining students. Subsequent audit work has confirmed that those issues were not properly addressed in the years before the merger, due in part to a lack of leadership on the curriculum and a lack of clarity about roles and responsibilities.

The college now has a good understanding of the issues that have led to its current financial position and it is making progress with its transformation plan, including a review of the curriculum. It has also put in place stronger governance arrangements. The college is confident that it will meet its 2016-17 activity targets, and that progress is welcome, but it continues to face significant financial challenges and its future sustainability depends on successful implementation of the remainder of the transformation plan.

The college also needs to make substantial savings through voluntary severance. Although the funding council has provided assurances that it will continue to support the college, that is contingent on the college continuing to implement the transformation plan. Any unexpected changes in the college's costs or income could lead to it needing further financial support.

Moving on to Lews Castle College, the auditor, Scott-Moncrieff, highlighted concerns about financial sustainability as a result of the college not achieving student activity targets. The auditor also highlighted that delays in appointing board members had had a significant impact on governance.

Although the college is not in immediate financial difficulty, it has missed its target over an extended period, and the margin by which it missed the target in 2015-16 was significantly higher than in previous years.

In multicollge regions, the funding council provides funding to the regional body—which, in this case, is the University of the Highlands and Islands—and that body is then responsible for agreeing activity levels and allocating funding to the colleges in the region. Because the region overall exceeded its target, the funding council did not seek recovery of funding from UHI, and UHI did not seek any recovery from Lews Castle College. However, there is a risk that continued underdelivery could result in both a reduction of future funding and recovery of funding for past activity that was not delivered, and any such reduction or recovery would have a detrimental effect on the college's financial sustainability.

The college board and committees considered performance regularly, but there is little evidence of the board taking effective action to address the risks. The college developed new marketing, employer engagement and curriculum strategies from 2014, but they have not delivered the intended increases in student numbers. The college is still working with UHI to agree a revised activity target and to adjust its cost base to match that.

Our final report relates to Moray College. During the year, the college urgently needed to draw down an advance of £697,000 on its funding allocation from the regional body—which, in this case, is also UHI—as it did not have enough money to meet its operating costs. This was the second year in which the college needed to request an advance of funding.

In January 2016, the college was forecasting an end-year surplus of £145,000; by April, however, that had changed to a forecast deficit of £499,000. The auditor from Audit Scotland found that although the management accounts analysed the areas of overspend, they did not provide explanations for variances between budgets and forecasts, and further problems arose when budgets and cash-flow forecasts were not updated to reflect new information.

The college's current financial position is not sustainable, and it is currently discussing a recovery plan with UHI and the funding council, based on reaching financial balance by 2019. It is important that UHI ensures that the college can deliver on its priorities within the resources available to it, and obviously the college board will also have an important role to play in monitoring the college's progress with the agreed recovery plan.

All three colleges face different challenges, but all need to take action now to get on a firmer financial footing. As always, convener, my colleagues and I will do our best to answer your questions.

The Acting Convener: Thank you very much. We will take each of the colleges in turn, starting with Edinburgh College. Can you confirm that your report on that college builds on the issues that were identified in your previous report? I am keen to establish whether anything new has arisen in the current report.

Caroline Gardner: Yes, the current report builds on my previous report and the evidence-taking sessions that the committee held with college representatives prior to the publication of this report. It is worth highlighting two key differences: first, there is an update on the financial position and progress on the recovery plan for 2015-16; and secondly, there is a bit more

detail on the principal's investigation of the underlying causes of the problems. Those committee members who were in place when I presented my previous report will recall that the issues in question came to light very shortly before the deadline for laying section 22 reports before the Parliament. Since then, we have taken the opportunity to do some more work on the issue and to investigate the underlying causes. You will find that in my report.

The Acting Convener: Thank you. That was very helpful.

Colin Beattie (Midlothian North and Musselburgh) (SNP): One significant issue is that everyone who was apparently involved in this has gone, and there is now nobody to point the finger at. However, I am interested in exploring the role of the board a bit more. In paragraph 28 on page 9 of your report on Edinburgh College, you say:

"Board members told us that, during 2013/14, it became clear that there were financial problems at the college, but that the root cause of the problems was not clear from the information provided to the Board."

What did the board do about that?

Caroline Gardner: My understanding, which I hope is reflected in the report, is that, because of the lack of clarity between the roles and responsibilities of the two people responsible for the curriculum, the information that was reaching the board was not adequate to enable the board to pursue the questions that arose.

Colin Beattie: Again, the question is, what did the board do? It had a responsibility.

Caroline Gardner: I will ask Hugh Harvie to pick up on the details.

Hugh Harvie (KPMG): As I understand it, when the board was considering the budget for 2013-14 towards the end of 2012-13, there was a budgeted deficit of about £1.7 million as a result of post-merger pay awards and anticipated reductions in SFC funding. My understanding is that those arrangements were made to align the pay awards across the three former colleges.

Colin Beattie: Can I ask about the pay awards?

Hugh Harvie: Yes.

Colin Beattie: Surely the college would not have budgeted to go into deficit to make those awards—it would have agreed some sort of funding with the SFC.

Hugh Harvie: I am not sure whether anything was agreed with the SFC, but I am aware that there was a budgeted deficit for 2013-14.

Colin Beattie: Was a large part of that for the voluntary redundancy awards?

Hugh Harvie: That was an element of it. I am sorry that I do not know the exact details of that.

Colin Beattie: I am concerned because it would be extraordinary if the college was budgeting for a deficit without having made some arrangements to cover that deficit by getting it from the SFC, from its own reserves or from elsewhere.

Hugh Harvie: The cash reserves in the college at that time were able to support that deficit.

Colin Beattie: Okay—I go back to the board, then. What did the board actually do? It became clear that there were problems and that there was a deficit. What action did the board take? It had a responsibility.

Hugh Harvie: I do not know what the board did at that time. I do not mean to avoid the question, but I was not the auditor signing the accounts at that time; it was a predecessor of mine. I am sorry that I do not have the details that I would have had if I had been there.

Caroline Gardner: We go on in paragraph 28 of the report to say:

"Board minutes show that during 2014/15, the Board was provided with assurances by the executive team that the college would achieve its student activity target."

That would clearly have a knock-on effect on the financial position of the college. We also found that

"the Board raised the need for the development of management information".

Where things failed was that the lack of clarity about roles and responsibilities in the college meant that that information was still not reliable enough for the board to do its business.

Colin Beattie: Was the board inquiring enough? Did the board members carry out the function of interrogating the officers?

Caroline Gardner: The evidence from the board minutes suggests that it was carrying out its role as expected. Where things fell down was in the response that it received from members of the executive team, and that rolled on through to the principal's review and the departure of key members of staff at that point.

Colin Beattie: As all that unfolded over a period of years, the board realised quite early on that there was a problem. It received assurances, and I presume that it received repeated assurances as the situation deteriorated. What did board members do?

Caroline Gardner: You will see the story coming through in the report. They asked for that information. In 2015, a new principal was appointed who started to dig into the underlying causes of the issues, which were based on long-

standing problems with the curriculum as well as the lack of clarity about roles and responsibilities. At that point, there was a restructuring of the college, and eventually there was the departure in different ways of key members of the previous executive team. A recovery plan was then agreed on.

The evidence that we have suggests that, given the long-standing nature of the problems and the lack of clarity about roles and the performance of the people carrying out those roles, the board was probably doing as much as it could in a difficult situation. It is also worth noting the backdrop to that, which was the merger of a number of colleges to form the new Edinburgh College. A number of other changes were also going on. There were a lot of changes for the board to get to grips with.

Colin Beattie: Presumably, members of the board would have headed up committees, including an audit committee. Would they not have been in a position to obtain more information, or should they have been in a position to be more inquiring and to ask more questions?

Caroline Gardner: Our impression overall is that board members were asking the questions, but the underlying problem was not well understood and the information that they were getting simply did not unpick those questions for them well enough, until a new principal was appointed in 2015 and the sequence of events described in the report took place. It is always a matter of judgment to say how far that could or should have been pushed, but the evidence from board minutes is that board members were certainly asking the right questions and receiving assurances from officers about those questions.

Colin Beattie: It certainly seems that there is still a question about the role of the board.

09:15

Liam Kerr (North East Scotland) (Con): Good morning. You have talked about the vice-principals and various additional responsibilities. You might recall that I was quite exercised about lines of responsibility when we had Edinburgh College before us. At the time, we were told that there was a general malaise and that no single individual was responsible, but the report tends to suggest that a single individual was responsible. I am curious about aspects of that. We must have known about the vice-principal curriculum and quality competency hearing at the time of the previous audit and assessment. Will you comment on that, please?

Caroline Gardner: I outlined the timeline in response to the convener's first question. My report was finalised between February and March

2016, very shortly after the problems relating to the financial position had emerged. Since then, the committee has heard from the principal of the board and her colleagues. I cannot comment on what she told the committee, but I can give the assurance that, since then, Dharshi Santhakumaran has done a lot of audit work in the college to look at the underlying causes and the action that has been taken. The information on pages 6 and 7 of the report reflects our findings.

The competency hearing had probably been scheduled at that point. Other factors may have affected the principal's evidence to the committee, but we have set out our full understanding of the sequence of events and the underlying causes, based on the audit work that has been carried out since.

Liam Kerr: Why did the principal not tell me about the competency hearing? I recall specifically asking who was responsible. I suppose that you will say that that question is for the principal to answer, but I wonder whether there is more to be done in the light of the new information that you have. I think that I asked a direct question and that it was dodged at the time.

Caroline Gardner: I am afraid that I cannot say why the principal gave you the answer that she gave. If I were to speculate—I stress that I am speculating—I would say that it is rarely the case in such situations that one individual carries all the responsibility. You will note, from the sequence of events that is set out on pages 6 and 7 of the report, that the other vice-principal had previously applied for unreceived voluntary severance. I do not know whether that underpins the clear-cut division of responsibility between the two individuals or whether it was simply the sequence of events as the management structure was reviewed and decisions were taken, but we have set out our best understanding of what happened. The principal would have to answer your broader question about the reasons for the answers that she gave to the committee.

Liam Kerr: I want to stay briefly on that issue. These questions may be for Dharshi Santhakumaran.

What review of the recruitment process has been done? I am somewhat concerned about the idea of matching. It seems that a person was just given a post and that, on reflection, it was discovered that they were manifestly unsuitable for it. Did the individual resign in response to being told that they would be under investigation? If so, their record will be clean, and they may have gone off to do something similar.

Dharshi Santhakumaran (Audit Scotland): As far as the matching is concerned, the development plan that the interim principal put in place featured

a restructuring of the executive team. That was carried out when the current principal came into post in May, and the two vice-principal posts were merged. I do not have a lot of details about the job-matching process, but I understand that the fit was 60 per cent or more with the vice-principal curriculum's job, which is why he was matched to the post. You would have to ask the principal whether there should have been a more formal recruitment process.

I am sorry, but what was your second question?

Liam Kerr: According to the timeline in the report, the board identified a concern with the individual and, shortly afterwards, the individual resigned, apparently with a completely clean record. I wonder whether the individual resigned in response to a tip-off that some action was going to be taken or whether they were just moving on.

Dharshi Santhakumaran: As the report says, and as I understand it from the principal's investigation, at the point at which the board was informed that the vice-principal curriculum would undergo the competency hearing, the principal spoke to the vice-principal in question, who resigned following that. I could not comment on the motivation for his resignation.

Liam Kerr: Sure. Let us move on. I have some concerns about the voluntary severance scheme. It appears that the first voluntary severance scheme, which ran from May to June 2016, had a cost of £1.14 million, with expected savings of £1.12 million. It therefore appears to have cost more than the anticipated savings. Is that the case? If so, do you feel that lessons have been learned from that?

Caroline Gardner: The team will keep me straight on this. The way in which it is normally reported is that the cost is a one-off and the savings are recurring annual savings. You are right in saying that that is not made explicit in the report—I apologise for that. Normally, they are annual savings that recur year after year. That is my understanding of what has happened here.

Liam Kerr: I understand. However, the phase 3 scheme is more challenging because it targets a different demographic—the academic staff—and it is going to strip out a significant number of those people. Is that going to work in purely financial terms? It seems to me that the product that the college sells is its academic expertise. Do you have concerns about having a college without staff?

Caroline Gardner: You are right that having the right staff with the right skills and the right teaching experience is critical for the success of any college. The voluntary severance scheme for academic staff is timed to follow the curriculum review element of the transformation plan. The

college needs to review its curriculum to ensure that it is meeting the needs of students and employers and that it can afford to deliver that within the activity targets and funding that have been agreed with the funding council. The college's intention is to complete the curriculum review and then identify what staffing is needed for the future curriculum that will be in place. It will invite voluntary severance applications to try to bring the two into line with each other.

As we say in the report, with any voluntary severance scheme there is a risk that the people who apply for voluntary severance will not necessarily be the people whom we would most like to lose from the workforce or those who are least critical to the delivery of the future curriculum. The college has the right to refuse any individual application, but there is a risk that it will not receive enough suitable applications to make the savings that are intended. We highlight that risk in the report.

Liam Kerr: Yes, and I think that you are right to do so. That issue would be my significant concern. What is the back-up plan? If the existing plan does not work, what will happen?

Caroline Gardner: I think that there are two routes open to the college. The first, and less likely, route is that it could try to raise significant funding from other sources to replace the income from the funding council that it will likely continue to lose as its activity targets come into line with what it is able to deliver in the future. The second, and more likely, route is that the college will have to negotiate with the funding council either changes to its targets or more transformation funding to give it the time to make the changes that are needed. However, as I say in the report, there is a significant risk to the delivery of the transformation plan and the college coming back into financial balance.

Liam Kerr: Thank you.

Monica Lennon (Central Scotland) (Lab): Good morning, everyone. On page 12 of the report, we are told that the college plans to make further savings in estate management across the four campuses. Do you have any more information on that, Auditor General? I would be interested to know what impact that might have on the students.

Caroline Gardner: I think that the estate work is part of the overall financial sustainability element of the transformation plan, so the college is taking a planned approach to it, as you would expect. I do not think that the planning work is complete yet. Hugh Harvie may be able to add more about that.

Hugh Harvie: As I understand it, the planning work is not complete. The work to determine which elements of the estate are required will follow the

curriculum review. Everything falls into place behind that.

Monica Lennon: Do you foresee any changes to the availability of courses, for example?

Hugh Harvie: It is difficult to predict what the curriculum review will throw out. There are four campuses, and where the courses will be delivered remains to be seen. The largest part of the transformation plan is getting to the bottom of that.

Monica Lennon: Will the curriculum review inform the estate management review? Is that how it works?

Hugh Harvie: Yes. It should fall into place behind that.

Monica Lennon: Also on page 12, in paragraph 42, you highlight the importance of cash flow management. You say:

“Cash flow management is a critical component”

and you highlight a number of areas including

“the outcome from national bargaining.”

That is clearly a live issue, as we currently have the biggest industrial action that we have seen in education since the 1980s.

The financial pressures that you have highlighted are well rehearsed, but is there any link between the current industrial dispute over national bargaining and the financial pressures that colleges such as Edinburgh College are facing?

Caroline Gardner: The national pay bargaining that follows from reform and that was intended to harmonise terms and conditions right across the sector obviously affects all colleges, and it affects them in different ways depending on their starting points. Some colleges are closer than others to what will finally be agreed, so there will be less of a financial impact on them. You will see in one of the reports that we will come on to later this morning that, in previous years, a failure to plan for the impact of pay negotiations had an effect on the financial position.

That has not led to the position that Edinburgh College is in, but it is clearly a financial pressure that that college and others will need to accommodate in the future, once they know the final details. All colleges should be doing some scenario planning now to understand what it might mean for them and how they would fund it, given the other pressures that are around.

Monica Lennon: Colin Beattie mentioned the board. I understand that Ian McKay, who is the chair of the board at Edinburgh College, is also on the board of Colleges Scotland and is the chair of the employers association, which is involved in the

negotiations with the Educational Institute of Scotland. Do you foresee any conflicts of interest there?

Caroline Gardner: I cannot see a particular conflict of interest. On the one hand, in a country the size of Scotland, anybody with the experience and insight to be able to lead the negotiations for the employers is likely to have a role with one of the colleges in order to have built up that experience. Equally, the negotiating team on the staff side will have an interest in terms of representing or being members of college staff. That is not an unusual feature of any industrial negotiation. The question is what the long-term costs will be for the sector as a whole and what the negotiation will mean for individual colleges, given that it will differ from case to case.

Monica Lennon: Thank you.

Willie Coffey (Kilmarnock and Irvine Valley) (SNP): I apologise if this issue has been covered in previous discussions at the committee. Auditor General, your 2013 report highlighted that Edinburgh College's income had dropped by about £11 million, and it mentioned that a substantial portion of that income—£1.6 million—had been lost mainly through the overseas student programme, which the United Kingdom Border Agency had stopped. Shortly after that, the funding council issued its guidance on additionality. Is there a correlation between the college losing income and the emergence of more additionality to top up courses as a means of trying to balance income?

09:30

Caroline Gardner: I do not think that we have the evidence to support that as a clear finding in this case. It is true that one of the reasons why the funding council wanted to put limits on additionality was the perceived risk that it could be used by some colleges to mitigate financial pressures from other sources. One of the underlying issues in Edinburgh College was that long-standing problems with recruiting and retaining students were not apparent to the board because of the use of additionality to top up the income flows to the level that was expected. It is possible that the drop in income that you highlight was a factor, but the broader question is whether the funding council recognised that additionality was not being used as planned, to broaden the coverage of further education, and therefore put measures in place to limit it.

Willie Coffey: The way in which additionality is used seems to be an issue in all the reports. You said in your opening remarks that Edinburgh College is confident that it will meet its activity targets. Does that mean that the issue of

additionality has now been addressed with the funding council?

Caroline Gardner: Yes. When we finalised the report, both Edinburgh College and the funding council were confident that the college would meet its overall 2015-16 target. We know that the funding council is monitoring the use of additionality very closely, particularly in that case, as we would expect. That suggests that the combination of the college putting its house in order and the funding council's reduction of its target is helping to bring it closer to balance on the back of the plan that runs to 2019-20.

Willie Coffey: Have the overseas programmes come back on to the table in any way, or have they been swept away so that they are gone and lost forever now? Do we know that?

Caroline Gardner: Can Hugh Harvie or Dharshi Santhakumaran say anything about that?

Hugh Harvie: I am not sure.

Willie Coffey: The programmes provided a substantial annual income that the college was able to call on.

Caroline Gardner: I am hearing from the team that we do not think that that is the case. The uncertainty around Brexit may also be having an effect, as it will have for other colleges.

Alex Neil (Airdrie and Shotts) (SNP): When we look at the three college reports, there is a clear pattern of the ineffectiveness of the boards in dealing with the financial situation, even after the board has become aware of the challenges in reaching targets, managing budgets and projecting surpluses and then deficits within a short period of time, with wild swings between the forecast surplus and the forecast deficit, as in the case of Lews Castle or Moray.

That is a general pattern in the public sector. The Scottish Police Authority evidence clearly showed that the board had not been nearly as effective as it should have been.

Two issues are involved, the first of which is the general pattern of the boards of those public bodies not doing their job properly. Why is that and what do we need to do to get that sorted? Secondly, there is a specific issue in the college sector relating to the non-executive board members. To be fair to them, they are unpaid other than expenses, and that may be a factor in why so many college boards are just not performing. We have to take that into account, both in terms of how it may affect the calibre of the people who are on those boards—does it negatively affect their level of commitment and performance?—and in deciding whether we should be paying them. If we paid the non-executive board members, would that improve the

boards' effectiveness—would we get real value for money by paying them something, at least, to recognise their service?

Caroline Gardner: That is a really important question. Mr Neil is right—clearly, there are some boards that have not carried out their responsibilities well in the public sector. Equally, some very effective boards are leading their organisations through difficult times, so I do not want to have a blanket condemnation of the way in which boards are working.

The report on the role of boards that Audit Scotland published back in 2010 highlighted a number of issues about the variation between boards of public bodies—their membership, how members are appointed, how they operate and the expectations on them—and there are some important questions in there that would be worth a closer look. We are certainly looking at that as we think about our future work programme. One of the important things is the relationship between the board and its sponsoring department in Government. Some of those relationships are direct and some of them are indirect through funding bodies such as the funding council, but the ability to spot problems early and tackle them seems to be very variable.

That is also an important question from the Government's perspective. You are right to say that further education boards are very unusual now, in that their members are unpaid, and they appoint their own members rather than having them appointed through the public appointments process, in most cases with ministerial approval.

Before regionalisation, most further education boards and organisations were very small, which often made it harder for them to attract strong members with broader experience. Since regionalisation, many boards have become larger, but they are still small compared with the boards of other public bodies.

It is difficult to overestimate the scale of change that those boards have been through over the past three or four years, given that there have been lots of mergers, regional bodies were introduced, the funding process and the way in which targets were set changed and there was a significant change in Government policy, which moved funding away from part-time students and towards younger full-time students who are working towards vocational qualifications. All that has created an environment in which it is difficult for board members to perform their roles.

The two reports that you will consider later this morning state that the phasing of board appointments and retirements during the period has led to loss of expertise. All that has caused particular problems in the further education sector;

problems that can emerge in any public sector board have emerged in a higher volume there than they have elsewhere.

Alex Neil: Perhaps we need to look again at the whole issue. Why are some boards effective and other boards are ineffective and perform poorly? Is there a pattern? Do we need to do something to the general policy on appointing and selecting board members?

As a minister, I always asked for the original list of applicants and I often found that I knew people who had been turned down in the first phase. In some aspects, the public appointments selection process is frankly defective right from the beginning. I remember one case in which a former Labour health minister was turned down on day 1 for a health board position. Although he was not in my party, I would have appointed him if his name had come to me, because I knew that he was well and truly up to the job. By the time that ministers get the list of applicants, they have a very limited choice. The system is not working anything like as fairly or effectively as it needs to.

A related issue is how arm's-length external organisation boards are appointed by local authorities and whether they should be brought under the ambit of the public appointments code and system, because the process is wide open to corruption.

Caroline Gardner: We hear anecdotal concerns similar to those that you outlined about people not understanding why apparently qualified candidates did not make it through the process to be presented to ministers. Equally, we know from our work that the number of applicants has dropped over recent years, which is clearly a concern. If you are trying to attract high-quality candidates and diverse board members, you want a wide range of as many highly qualified people as possible to put their names forward in the first place. The issue is worthy of attention.

The public appointments process is at the edge of my remit, but the broader question of boards' role and effective governance is at the heart of it, and we are looking at that matter now.

Alex Neil: It would be interesting to see whether the success rate for applicants who are retired civil servants is markedly higher than it is for those who were not civil servants. I suspect that it is.

The Acting Convener: As is the success rate for retired politicians.

Alex Neil: That is certainly my impression.

The Acting Convener: Before we drift even further, we will move to consideration of the report on Lews Castle College.

Liam Kerr: I have a degree of sympathy for Lews Castle College, given the demographic shift that has happened. However, it appears to have missed the target for about eight years. Did the SFC or UHI not step in at any point to say, "Hang on, there's a problem here", and if not, why not?

Caroline Gardner: As the report states, the college has missed the target for a number of years. The extent to which it missed the target varied from year to year. In the early part of the period, the funding council allowed an element of leeway on either side of the target in order to give colleges a bit of flexibility. I have reported now because the shortfall has increased quite markedly in the past year and there are real questions about financial sustainability. Mark MacPherson can tell you a bit more about what the funding council has done over that period.

Mark MacPherson (Audit Scotland): If we look at exhibit 1 in the report, we can see that in the early part of the period there was a significant underdelivery in 2008-09, but there was some improvement over the subsequent years. Even in 2010-11, although the delivery was outside the leeway, when the total number of hours was added up it equated only to about two students, so the funding council did not feel that it was right to make a clawback for that relatively small amount.

The real change began to happen in about 2012-13. That was the point from which regional targets applied. The funding council made the decision that, since the region had achieved the target, it was not going to pursue recovery from others. However, the figures for the past two years—2014-15 on which we reported in our overview report last year, and then this year—indicate significant difficulties that have not really been addressed in the preceding years.

Liam Kerr: Is it possible that other colleges are in the same situation, but that that has not been picked up yet?

Caroline Gardner: We monitor the annual reports and accounts of all the colleges, and those feed into the annual overview report that we produce. There is a related issue in the report on Moray College that we will come to shortly. Both Lews Castle and Moray are within the UHI region, and the region as a whole is meeting the target that was agreed with the funding council.

When we think that there is more than just a minor problem that can be corrected within the normal management of the organisation, our aim is to bring it to the attention of the committee through the section 22 report. The three colleges that we are looking at today are the ones that we have real concerns about at the moment. We will continue monitoring what we are seeing in individual colleges year on year, and we will bring

concerns to the committee's attention as necessary.

Liam Kerr: It feels as though there is a basic issue of fairness here. In effect, Lews Castle is allowed to underdeliver because others can overdeliver, if I can put it that way. If the SFC was to reduce the funding, presumably UHI's overall funding package would be reduced. Would there be an expectation—or could the SFC mandate—that UHI would pass on that reduction specifically to Lews Castle, or would it be within UHI's discretion to spread that reduction across all its colleges?

Caroline Gardner: Since the reform of colleges and the introduction of the regional bodies, the funding model has been that the agreement on activity targets and funding is between the funding council and the regional body. Therefore, it is for UHI to agree with the colleges that make it up how the funding and activity will be distributed between them. That is now the subject of a review in the region, to make sure both that there is fairness between colleges and that any movements that are needed do not put individual colleges at immediate risk. Clearly, whenever there are winners and losers, the position is difficult to manage. The way in which the review is taken forward will be critical to the future of both Lews Castle College and Moray College.

Liam Kerr: Does that concern you? Presumably, if UHI was to take a decision not to pass the reduction to Lews but to share it that could, first, mask the problems at Lews. Secondly, it would mean that a college in a multicollage region would have a significant advantage over colleges in regions where they stand alone.

Caroline Gardner: The first thing to say—we say this in the report—is that both the college and UHI have recognised that they were slow to understand the implications of the new funding model when it was introduced. They probably wish that they had done the review that they are doing now when the arrangements first came in. Beyond that, Liam Kerr is right that there is a real question of making sure not just that the funding is fair to the colleges, but that they are well placed to meet the needs of students and employers in their regions. That is particularly important in a very remote and rural area such as the UHI region, where there may not be obvious alternatives in the way that there are in parts of the central belt, for example. The review is very important.

Reducing the activity targets has the consequence of reducing the funding that is available to the individual colleges in the region. UHI and the funding council will need to be assured that those changes can be made in a way that is fair to students and to staff within the

organisation and that the financial shifts can be made in a sustainable way.

09:45

Mark MacPherson: On the review that the Auditor General refers to, we received some information just in the past week that indicates that changes have been made to the targets for each of the individual colleges, and that Lews Castle College will see a reduction in its target for 2017-18; I think that it has now completed the work that it has been doing over the past little while. We have not looked in detail at the full implications of that, but obviously we will be interested in doing so in next year's work on the audit and the overview.

Liam Kerr: Caroline Gardner mentioned a misunderstanding of the effects of changes introduced by the SFC, which is alluded to in paragraph 14 on page 7 of the Lews Castle College audit. To some extent, Edinburgh College had the same problem in relation to additionality. Do you extrapolate from that that there is an issue with the SFC's communication when it is making changes? Are we blaming the colleges for misunderstandings that perhaps have a root cause that is higher up the chain?

Caroline Gardner: That is a very good question and it is one that we have considered, as you would imagine. The conclusion that we have drawn on the back of our work with the colleges and the funding council is that the funding council did as much as could have been expected in terms of communicating the changes to the sector as a whole and to individual colleges. However, against a backdrop of all the changes that I have outlined, falling funding from the funding council to the sector, shifts in the policy on who the priority students and learners are, regionalisation, mergers and changes to the governance overall, a number of colleges did not fully understand the impact of the changes on them. That has been ratcheted up in the cases that we have brought to you because of particular circumstances in the colleges.

With Edinburgh College, we have talked about the lack of clarity on the effect of additionality and the unclear roles and responsibilities. In the Moray College audit, we talk about the lack of capacity in the finance team. Those local circumstances made the situation worse but I think that we have concluded that the funding council was not underplaying its responsibility to communicate clearly the changes that it was making.

The Acting Convener: Monica Lennon wants to follow up on the funding council.

Monica Lennon: Auditor General, you just said to Liam Kerr that the funding council did as much as could have been expected. I guess that you are

saying that no one in particular is to blame for that lack of understanding. That leaves me wondering whether we have a sector that is overwhelmed by all the reforms and all the changes and perhaps by reduced capacity. Is such misunderstanding inevitable when we have these big reform programmes?

Caroline Gardner: I do not think that such misunderstanding is inevitable, but I think that a huge amount of change happened at one time in the further education sector, based on the Post-16 Education (Scotland) Act 2013, at the same time as there was a shift in Government policy and a reduction in Government funding. All of that together created a very unusual set of circumstances.

Colleges had a lot to deal with; equally, the funding council had a lot to deal with at that time. There may be lessons for future reform programmes about prioritising particular changes rather than taking the big bang approach of doing it all at one time.

Monica Lennon: When it becomes apparent that there is a lack of understanding, whose responsibility is it to try to flag that up?

Caroline Gardner: That will differ in different circumstances. In the case of Lews Castle College, we had UHI, which was a long-established university in relative terms, taking on new responsibilities for overseeing and funding FE colleges. It took UHI some time to work through that.

We had a number of very small colleges—both Lews Castle College and Moray College are small and had their own capacity challenges. I know that this is not an answer that sits comfortably with the committee but I think that there is no individual who is responsible beyond the individual accountable officer responsibilities through the chain of accountability to work it through.

Every accountable officer has a responsibility to ensure that they have effective controls in place to manage the public resources that they are responsible for. That runs through from the funding council to UHI and the individual colleges.

Michael—is there anything that you would like to add on the context around the understanding of the issue from the perspective of Lews Castle College and UHI?

Michael Lavender (Scott-Moncrieff): Not a great deal, to be honest. As you have said, the range of changes in the sector has had an impact. The college and UHI have flagged up that there were potentially misunderstandings, which they felt led to the activity targets being set higher for Lews Castle College under the credit scheme than they should have been. They felt that that was the

principal driver for the underachievement, mainly in 2015-16. As Mark MacPherson mentioned, there have been discussions in the regional body, which will mean that the Lews Castle College credits targets will be lower. They seem to be more achievable, although the college will have to take into account the reduced income as a result of that.

Mark MacPherson: It is worth bearing in mind that the targets are meant to be agreed between the region and the SFC. UHI and the colleges should have an opportunity to say whether they believe that the targets are not set at the appropriate level, and they should continue with negotiations if they feel that that is needed to get to the right figures.

Monica Lennon: I have one more question, on the part of the report that highlights “Reasons for under-delivery”. In attempting to give an explanation, Lews Castle College pointed to

“the national policy focus on full-time courses”.

The report says:

“The college previously catered for a larger proportion of part-time learners and older ... learners.”

I do not know that part of the country terribly well but, on the local demography, I see that there has been

“a reduction in the number of young people”

in that catchment area, and that has clearly

“contributed to the college’s difficulty in delivering the target.”

In light of previous discussions in the committee, how realistic is it that colleges such as Lews Castle College can comply with national policy when it is clear that the demography of the local community is quite different? It is clear that there was demand before for part-time learning and for people to return to education. What impact does that demography have on student experiences and trying to minimise rather than increase inequality in that part of Scotland?

Caroline Gardner: We have reported previously on the Scotland-wide picture and the shifts in the student body that we have seen as a result of Government policy to focus on younger, full-time students whose courses lead to recognised qualifications. That has meant a reduction in older learners, women learners and part-time learners, and that will have different effects in different parts of the country, depending on the demography, as you said. The college thinks that the demography that it is serving has had a disproportionate effect on its ability to meet its targets and therefore to balance its finances.

As Mark MacPherson has just said, the college and the regional body have the responsibility to

negotiate their targets with the funding council and ensure that they are achievable. That negotiation has to take account of the national priorities, the student body that they serve, and the needs of employers in the area.

The late recognition of what that shift in policy and the shift in the target meant for the college has had an effect. The review that has been under way should deal with that if it is carried out effectively, but there may well still be a national policy impact in the area. That means that some students who previously would have been eligible for further education will not be eligible in future. That is an inevitable consequence of a policy shift of that nature.

Monica Lennon: Is there sufficient flexibility in the national policy to accommodate local differences?

Caroline Gardner: The national policy has been very clear. It is for any Government to set policy of that type, and I am specifically precluded from commenting on it. The question is how the policy is implemented. There is room in the negotiation between the funding council and the regional body to have that negotiation but, obviously, there is still a cap on the overall funding that is available, which will feed through to the agreed targets.

Colin Beattie: I want to continue on governance—I am sorry to be sort of worrying that issue. There is a pretty damning statement in paragraph 13 of the report, which says:

“there is little evidence of the board taking effective action to adjust the college’s operations to address these risks”.

It is clear that Audit Scotland would have expected the board to be rather more proactive in what it was doing. Paragraph 16 says:

“Seven experienced ... members left ... including the Chair.”

Was one the result of the other?

Caroline Gardner: The short answer to your second question is no. As we say in paragraph 13, the board was aware of the risks and put in place some changes to its marketing, its employee engagement and its curriculum strategies. However, they were not sufficient to address the scale of the challenges that it was dealing with. The departure of board members was a result of the Post-16 Education (Scotland) Act 2013, and the fact that a number of them had been appointed at the same time, which meant that their terms of appointment ended at the same time. That is also the case with regard to the Moray College report that we will come to later. Again, it is another effect of reform that made the whole thing more difficult.

Michael, do you want to add anything to that?

Michael Lavender: From the work that was carried out, we did not see a direct correlation between the two. The phasing of board members’ appointments is one matter. Historically, we can see in hindsight that the actions and discussions at board level were not effective with regard to ensuring that the college can meet its agreed activity targets.

Colin Beattie: So action was taken but it was inadequate.

Michael Lavender: From the work that has been carried out on the historical information, we can see that there were discussions at board level and actions taken as a result of those discussions. However, the figures in exhibit 1 show that those actions have not resulted in the college achieving the agreed activity targets.

Colin Beattie: I understand that there are 13 board members. Seven stood down, which clearly created a number of problems. There is something about the standing committees not having met for—from memory—almost a year, but you also say that there is no evidence that the absence of those meetings caused problems.

Caroline Gardner: No, I said that there is no evidence that the departures of the board members were a direct result of the problems that had arisen. In paragraph 17, we say that there is no indication that the absence of meetings affected delivery targets. However, obviously, boards play as key a role in the governance of further education colleges as they do in the governance of any organisation. Had the board and its committees been meeting, it is possible that the action that they took could have been more effective.

Colin Beattie: In paragraph 17, you say:

“Of the 13 current members, six had served on the board in the years immediately prior to 2015/16”.

Those six are the ones who carried on.

Caroline Gardner: Yes.

Colin Beattie: Is there a question mark over the continuation of members when there has clearly been an indictment of them and the actions that they have taken? What has the board done to reform itself and ensure that it does a better job? Aside from induction, which is just a routine process, has there been retraining of the board members? Clearly, a good chunk of the members who are still on the board failed in their duty before, so how do we know that they are not going to fail in their duty again?

Caroline Gardner: In a moment, I will ask Michael Lavender to give you more information

about other forms of board development or action that has been taken.

The continuation of the six members is a natural result of the desire not to lose all the experience that is already in place on the board, given that seven members had departed during the period, albeit one was reappointed. There is a question for the college, for UHI and, potentially for the funding council about whether more needs to be done to ensure that board members understand and carry out their roles effectively. However, it is not surprising that six members continued, given the need for some continuity.

Colin Beattie: Given the size of the college, 13 seems like quite a large board.

Caroline Gardner: We have previously discussed in this committee the variation in the size and composition of boards and the fact that, to us, some of them seem very large with respect to the role that they are being asked to carry out. I agree that, in this case, 13 looks like a large number. Of course, there are requirements for staff and student representation and for employer representation, but I think that a balance has to be struck between hearing the voice of the stakeholders and having a board that is small enough to ensure that it carries out its governance role effectively.

Colin Beattie: That brings us back to the question of what is being done to ensure that the board will be effective in the future.

Caroline Gardner: Michael, can you add anything to what we have said in the report?

10:00

Michael Lavender: It is difficult for me to comment, because the audit cycle has now moved on and my firm is no longer the appointed auditor, which means that we do not have sight of the on-going development and training of the board. A lot of the movement happened around the year end, which was at the end of our appointment process. We flagged up in our annual report that inductions had not even taken place for some of the board members. As is set out in the Auditor General's report, that induction process has now taken place, so some development is going on. My understanding is that UHI as a whole is involved in the on-going induction and training and development of board members. That potentially takes place on the mainland, and Lews Castle College might have some difficulty in relation to the cost of sending board members to the mainland for training, which it will have to work out with its regional body and its partners.

I would flag up the fact that, given that it now looks like the activity targets for Lews Castle

College will fall, it can be inferred that the underperformance in 2015-16 is overstated. If the activity targets are found to have been too high, the college, while still underperforming, might not have underperformed as badly as might appear to be the case.

Colin Beattie: Auditor General, given the comments on boards and the issues around their effectiveness and so on, in future audits, would you consider commenting more strongly on the effectiveness of boards? In the case of Edinburgh College, the board was almost invisible until the latter stages.

Caroline Gardner: Michael Lavender referred to the new audit appointments that came into effect last November for the next five years. Those new appointments are accompanied by a new code of audit practice, which strengthens the expectations that I place on the auditors that I appoint to comment on the wider dimensions of public audit, one of which is governance. The audit always covered those wider dimensions, but we often saw a description of the governance arrangements, rather than a conclusion about their effectiveness. I hope that the code of audit practice will support more clarity in the auditors' work in relation to whether the governance arrangements are effective. Obviously, that will provide a firm basis for me to report to this committee about them.

Willie Coffey: I would like to spring to the defence of Lews Castle College. There is a huge difference between Edinburgh College, which has 30,000 students or so and is in the capital city of Scotland and Lews Castle College in the Western Isles.

The measurement criteria that are being used are a wee bit harsh. We are saying that the college has persistently failed to meet its targets, but it is a small college and, if the main problem is to do with losing young people from the islands, it is hard to see how the college could meet its targets. Is it possible that the way in which we measure colleges is unfair when it comes to a college such as Lews Castle College?

I have another question. Are young people leaving the island because college courses are not available there, which means that they have to go to Inverness or beyond?

Caroline Gardner: That is a fair question. Obviously, the college is accountable for the funding that it receives, and that funding is linked to activity targets that are agreed with the funding council. There is a challenge in that all of that changed very quickly, and the college and the new regional body did not fully understand the implications of the changes. We are hopeful that

the revised targets that have been agreed will help to make that adjustment.

Obviously, there is a much bigger question about how we meet the learning needs of young people and other learners in remote parts of Scotland, and the islands in particular. That was a big driver for the establishment of UHI as a regional body for FE that could join up the provision between the individual colleges and between the colleges and the university to deliver better planned provision and better journeys for learners so that they can build their qualifications and experience in their local area. It is too early to see that working, because UHI is still in the process of agreeing revised targets with the FE colleges locally, but it is worth keeping an eye on how that is developing, and it is certainly something that we will be looking at through our audit work. It might also be something that the committee is interested in, given the particular issues in that part of Scotland.

Willie Coffey: I have a minor technical query. In the table on page 6, is there a correlation between the weighted student units of measurement totals and the credit totals? The weighted SUM total was around 9,000 and the credit total is around 6,000. Is there a direct correlation, or has a different formula been used?

Caroline Gardner: We try to explain that in footnote 3 on page 7, but I will ask Mark MacPherson to give you a quick summary of it, for the benefit of the *Official Report*.

Willie Coffey: I am just interested in the possibility that something might have been revised down to try to accommodate something, or whatever.

Caroline Gardner: The figures are related, but they are measuring the same thing in a different way. Mark MacPherson can talk you through how that works.

Mark MacPherson: The main difference is that previously a number of factors and weightings were included in the application of the weighted SUMs, but they have been removed in order to—as far as the SFC is concerned—simplify the model and have five separate categories. There are still weightings for aspects such as rurality, but they do not have as much bearing on the overall figure. Our understanding is that, although the credits target is broadly comparable with weighted SUMs, it will ultimately not be exactly the same. That is partly why the SFC has offered some protection for a number of years so that no college will be worse off over the period to the extent of more than 1 per cent.

Willie Coffey: Thank you.

The Acting Convener: As there are no further questions on Lews Castle College, we will move on to the report on Moray College. I invite questions from members.

Liam Kerr: I am interested in the staffing of Moray College. It appears that the staff costs are unsustainable going forward and that they are rather high, or certainly higher than the average across the country. Do you have any oversight of why that has been the case historically? Is it because the Moray College staff are being overpaid or is it because the college is overstaffed?

Caroline Gardner: Anne, can you offer any insight into the staffing costs of the college?

Anne MacDonald (Audit Scotland): Yes. In the numbers that are currently recorded, there has been no change for Moray College through the reclassification of colleges, which is different from the position in other colleges. As a way of making efficiencies, other colleges have been looking at the service that they provide and have been streamlining activities. So far, Moray College has not felt that it needs to do any of that and, as a result, its current figures are looking higher compared to those of other colleges.

Liam Kerr: That leads to the conclusion that there will be staff losses coming down the line. I note that the report refers to the planning of a voluntary severance scheme. Where are we on that?

Anne MacDonald: You will see in the report that we refer to a recovery plan, a significant element of which is the assumption that a severance scheme will go ahead. The scheme has been approved by the college board and has been submitted to UHI and the SFC, so it is currently with them for approval. The delivery of the severance scheme will be dependent on funding coming forward from the SFC/UHI, and my understanding is that the scheme will focus initially on trying to review the support to the support staff and back-office activities.

Liam Kerr: The issue really concerns me, because any severance scheme affects real people and their jobs, as well as the student experience, which Monica Lennon mentioned earlier. At the end of the day, management made decisions to recruit and hold the estate as it is, but you have talked about the support staff being in the first tranche, if I can put it that way. They will pay the price, and the students will pay the price, too. I presume that that is factored into the discussions on the recovery plan. Is that correct? Do people have oversight of those sorts of issues?

Anne MacDonald: At this stage, my understanding is that the scheme has been put in place as part of the recovery plan. I do not think

that it is at an advanced enough stage to understand the detail and how it is being taken forward.

Caroline Gardner: You are right, Mr Kerr, that voluntary severance schemes always affect both the services being provided and the lives of the people who lose their jobs or move on as a result. That has affected FE colleges across Scotland, given the significant reduction in funding that we have seen over the past few years. Our concern in this case, as Anne MacDonald has said, is about the delay in getting to grips with what the change in the funding model and the change in demand for courses mean for Moray College, which limits the possibility of doing that in a more strategic and more managed way. As I think that you are hinting, there is always a risk that suboptimal decisions will need to be made to balance the books because the opportunity to take a wider look over a longer period has been missed.

Liam Kerr: Colin Beattie has made a point a few times about governance. You mentioned that there may have been a failure to get to grips with new guidance and so on. Is that another example of management being challenged and perhaps not getting a full feel for what they have to do?

Caroline Gardner: What we are seeing in this case is slightly different. We are seeing a failure of financial management, which at the highest level manifested in the need to ask for what was effectively emergency funding from UHI in 2014-15 and in 2015-16 so that the college could pay its bills and meet its financial obligations. That should not happen in a public body; public bodies should have a good enough understanding of their financial flows to avoid the need for such emergency action to be taken.

In paragraph 10 of the report, we describe some of the things that necessitated the cash advance in 2015-16. Some of those were things that you would expect a finance function that was staffed by people of the right experience and calibre to see coming and recognise. If a finance function does not have the capacity to manage at a day-to-day level, it is unlikely to be able to take a longer-term view or to support the board to do so.

We also say in the report that, for the same reasons, the information that went to the board did not give it the emerging picture and its only option was to ask for an emergency advance on funding, rather than taking a longer-term view.

The issue that the report raises about the college's finance function is therefore slightly different.

Liam Kerr: I found it surprising that the college forecast an end-of-year surplus of £145,000 and then, three months later, had a £0.5 million deficit.

Was that just the result of a capacity issue in the prevailing circumstances at the time?

Caroline Gardner: That is exactly right. There was not a full understanding of the real financial position, which meant that that position was not reported to the board to allow it to fulfil its responsibilities.

Liam Kerr: I understand.

You mentioned the recovery plan, part of which is to increase income generation. Is that feasible? Can the college really increase income generation from other sources to such a level as to form part of the recovery?

Anne MacDonald: The college has looked at a number of options for new courses that will link more with Moray, such as courses on whisky. It thinks that it has two or three viable examples, but obviously new courses will not be introduced overnight; the college will need a bit of time to develop them.

Liam Kerr: I understand. Thank you.

Colin Beattie: I return to governance. Is the board that was in place at the time of the audit still in place?

Anne MacDonald: There was a refresh of the board last August. About four people from the previous board have continued and sit on the new board.

Colin Beattie: How large is the board?

Anne MacDonald: Eighteen people.

Colin Beattie: So, of 18 board members, only four are continuing.

Anne MacDonald: That is correct.

Colin Beattie: Is that a concern, given the loss of experience?

Caroline Gardner: It is, of course. As I said earlier, there is always a balance to strike between refreshing a board for whatever reason and having continuity. The underlying reason for that degree of turnover was the Post-16 Education (Scotland) Act 2013 and the implications of a number of appointments being made at the same point without the turnover question being thought through.

Colin Beattie: Paragraph 8 of the report states:

"Board and committee minutes did not evidence decisions or agreed actions to address the college's financial challenges".

It is pretty basic practice to record the decisions that are taken in the minutes. Are you saying that that did not happen?

Caroline Gardner: It did not happen. Anne MacDonald reported that in her 2014-15 audit report.

Colin Beattie: The same paragraph states that the steps that were taken were “not sufficient”. Whatever the board approved—we cannot be sure what that was—it was not enough.

The report states that previous audits highlighted a “lack of ... financial expertise” and so forth. I presume that those audit reports went to the board. Did the board do anything as a result?

Anne MacDonald: The college faced a lot of financial challenges over the course of 2014-15 and 2015-16. As we said earlier, it is a small college with a small finance team of about five full-time equivalents, or eight people in terms of numbers on seats. Over the course of most of this period, the director of finance was absent through long-term sickness, which definitely put pressure on the rest of the team. There were also staff changes. The main accountant who was there during the process came in—

10:15

Colin Beattie: But the board would have been aware of that.

Anne MacDonald: Yes. Absolutely.

Colin Beattie: What action did it take?

Anne MacDonald: The main problem in 2014-15 was with the assumptions associated with the higher education numbers and the further funding that was going to come from that. That was the main issue that led to the cash advance in 2014-15. It was not an issue in 2015-16, which I think means that, to a certain extent, the board felt that it was getting better information and had a better understanding of the context of the financial figures.

Colin Beattie: Did the board members know that they were not getting adequate information? They must have done.

Anne MacDonald: They must have done.

Colin Beattie: But they took no action.

Anne MacDonald: On the back of the recommendations, there was improved information during 2015-16 in that there was a much-improved narrative around the figures and the differences between budget and variances. However, the information still failed to explain the swings. In the report, we talk about the significant swings and how it had not been explained fully why those swings had arisen and why they could not have been seen in advance.

Colin Beattie: We are still looking at what the board was seeing. The report states:

“there was a lack of audit trails to support some ... figures included in management accounts.”

First, was the board getting incorrect or inadequate figures? Secondly, on the audit trails, what about internal audit—what was it doing about that?

Anne MacDonald: The board was getting the best information that finance felt that it had at that point in time, bearing in mind the capacity issues that I have mentioned.

Colin Beattie: But if there is a lack of audit trail to prove those figures—

Anne MacDonald: What I am referring to in terms of the audit trail is the lack of narrative supporting figures. The board was getting a statement with figures that explained the actual against budget but failed to explain the movements adequately. That is what I mean by a lack of audit trails.

Colin Beattie: It is pretty basic stuff.

Anne MacDonald: Yes.

Colin Beattie: If there were inadequate audit trails, what about internal audit? Who is responsible for the audit trails?

Anne MacDonald: Ultimately, it would be finance.

Colin Beattie: Internal audit must have a role in there someplace.

Anne MacDonald: The programme that is carried out by internal audit in this case is outsourced to a firm—there is no in-house internal audit function. A programme of work is agreed with the audit committee at the beginning of the year, and that will determine what internal audit is going to look at.

Colin Beattie: So internal audit would not pick up such inadequacies.

Anne MacDonald: That was not part of the schedule that it looked at this year.

Colin Beattie: I think that we have been through this before, Auditor General. The internal auditors are restricted in what they do by the contract that they have. As long as they tick the boxes, everything is fine—there is no intelligent overview of these things, which is a huge gap that has come up again here.

Caroline Gardner: For me, the issue is slightly different. Paragraph 12 of the report talks about the overall senior management of the college. Between April 2015 and February 2016, the college did not have a permanent principal, the director of finance was on long-term sick leave, the acting principal took on the role of the director of finance and there were problems within the

overall audit team, all of which issues were flagged by Anne MacDonald, as the auditor, to the board. For me, the bigger issue is that internal audit cannot compensate for that lack of capacity and strength within the senior management who are responsible for providing the board with the information that it needs to carry out its responsibilities.

Colin Beattie: We are saying that the board did not take the action that was required of it.

Caroline Gardner: The report says that very clearly.

Colin Beattie: Only four of the 18 members of the original board are still there. What sort of training are board members getting so that this does not happen again?

Caroline Gardner: We are likely to have the same issues that Mark MacPherson highlighted in relation to Lews Castle College. The University of the Highlands and Islands provides induction training, and the funding council provides support to board members. I do not know how many of the boards have been through the induction and other training, but it is often more difficult to provide it in a way that is readily accessible to board members in remote areas. That is something that I think that the new auditor will be following up when the audit work for 2016-17 gets under way.

Colin Beattie: It certainly raises a lot of questions about the boards, their actions and their understanding of what their responsibilities are and what they should be doing.

Anne MacDonald: Although my audit appointment just now has concluded, I can confirm from my experience with the new board from August through to Christmas that the board's finance and business expertise has increased. One of the new initiatives in the sector over the past year or so has been the code of good governance. A significant element of that concerns the effectiveness of a board, so the board delayed implementing or looking at certain aspects of the code until the new board was in place. Since the new board came in, it has done a full review, looking at its skills and at what has happened over the past year or two in the absence of the director of finance and with the change of principal. I was assured and felt a lot of comfort that the new board was totally on top of the current issues and would be taking action appropriately.

Colin Beattie: Let us hope that it is.

Willie Coffey: My attention is drawn to paragraph 10 in the Auditor General's report, which is about the cash advance and so on. A couple of items are of particular interest: the funding clawback of £79,000 for a European regional development fund project, and the delay

in the release of European structural and investment fund income. Is there an issue in the college with managing European bids and projects? Why would expertise, advice and guidance on that not be available from the UHI kind of top level? That is a bit concerning.

Anne MacDonald: The European funding was part funding for the construction of a new building for the college—the Alexander Graham Bell building. ERDF funding comes with a lot of conditions attached in relation to the information that should be kept and how the funding is used. European Union auditors will often come and review projects, as happened on that occasion; an audit of the project was undertaken by European Union auditors, separate from the audit that we do. There were problems with the audit trails and the paperwork that was retained. Because it was a significant project for the college, it had appointed external project managers and, from the outset, it was unclear who would be responsible for the record keeping and ensuring that all the audit trails were there for a sufficient period thereafter. They were able to bring most of it together, but there were some gaps and, as a result, there was a clawback. The clawback that is mentioned was £79,000. To put that into scale, the overall project cost was £6.5 million, of which £2.6 million was ERDF funding—the clawback was £79,000 out of £2.6 million.

Willie Coffey: That puts it in a bit more context. Thanks very much.

The Acting Convener: There are no other questions from members of the committee, so I thank the witnesses for their evidence and move the meeting into private session.

10:23

Meeting continued in private until 10:38.

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