AUDIT COMMITTEE

Tuesday 18 April 2006

Session 2

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AUDIT COMMITTEE
5th Meeting 2006, Session 2

CONVENER

*Mr Brian Monteith (Mid Scotland and Fife) (Ind)

DEPUTY CONVENER

*Mr Andrew Welsh (Angus) (SNP)

COMMITTEE MEMBERS

*Susan Deacon (Edinburgh East and Musselburgh) (Lab)
*Margaret Jamieson (Kilmarnock and Loudoun) (Lab)
*Mrs Mary Mulligan (Linlithgow) (Lab)
*Eleanor Scott (Highlands and Islands) (Green)
Margaret Smith (Edinburgh West) (LD)

COMMITTEE SUBSTITUTES

Chris Ballance (South of Scotland) (Green)
Mr David Davidson (North East Scotland) (Con)
Marlyn Glen (North East Scotland) (Lab)
Mr John Swinney (North Tayside) (SNP)

*attended

THE FOLLOWING ALSO ATTENDED:

Mr Robert Black (Auditor General for Scotland)
Dick Gill (Audit Scotland)
Bob Leishman (Audit Scotland)
Arwel Roberts (Audit Scotland)

CLERK TO THE COMMITTEE

Shelagh McKinlay

SENIOR ASSISTANT CLERK

Joanna Hardy

ASSISTANT CLERK

Clare O'Neill

LOCATION

Committee Room 5

Scottish Parliament

Audit Committee

Tuesday 18 April 2006

[THE CONVENER *opened the meeting at 10:03*]

Items in Private

The Convener (Mr Brian Monteith): I welcome committee members and the Auditor General for Scotland and his team to today's meeting of the Audit Committee. [*Interruption.*] My mobile phone going off is a timely reminder that we should all switch off our mobile phones and pagers, although my phone was just telling me that its battery is low. We have no apologies for absence, but we have apologies from Eleanor Scott, who will arrive later.

Under agenda item 1, the committee is asked to consider taking in private later in the meeting items 4 to 8. Item 4 is consideration of our approach to the Auditor General for Scotland's reports that are listed on the agenda; item 5 is consideration of our work programme; item 6 is consideration of the arrangements for our inquiry into the section 22 report on Inverness College; item 7 is consideration of a draft report on the "How Government Works" series; and item 8 is consideration of a submission to the Finance Committee's inquiry into accountability and governance. Does the committee agree to take in private items 4 to 8?

Members *indicated agreement*.

"Performance management in Scottish Enterprise"

10:04

The Convener: Item 2 is a briefing from the Auditor General on his report "Performance management in Scottish Enterprise".

Mr Robert Black (Auditor General for Scotland): In December 2003, I published a report on my special audit examination of Scottish Enterprise. That examination was a response to concerns expressed about target setting and performance measurement in Scottish Enterprise, its delivery of major projects and its use of consultants and European Union funding. The Audit Committee took evidence on the matter early in 2004 from Robert Crawford, who was then the chief executive of Scottish Enterprise. The committee's subsequent report stated that it would welcome a more detailed review of Scottish Enterprise's performance measurement arrangements at some point in the future.

This latest report is my response to the committee's suggestion. It considers the range of information available to assess the performance of Scottish Enterprise, the adequacy of such information and how it is used in Scottish Enterprise to encourage continuous improvement. The main finding of the report is that there have been a number of positive changes in Scottish Enterprise. However, it remains difficult to judge the organisation's impact on the Scottish economy. To a large extent, it is fair to say that that reflects the complexities of measuring the impact of an economic development agency—those problems are by no means unique to Scottish Enterprise. Nonetheless, I suggest in my report that Scottish Enterprise needs to strive to provide better and more complete information in this area. I know that it is committed to that objective.

My report begins with an overview of the Scottish economy's performance because it is important that a context is set for the analysis of Scottish Enterprise's performance. The overview is followed by a review of the available performance information. Finally, the report looks at what systems are in place to support the development, monitoring and evaluation of Scottish Enterprise's activities. I will briefly comment on each of those areas.

First, on the Scottish economic context, the Scottish economy is of course subject to a wide range of external influences that are beyond Scottish Enterprise's control. They include, for example, interest rates, exchange rates and the performance of the rest of the United Kingdom's economy and of international economies. Scottish Enterprise has a role to play in influencing economic performance, but clearly it cannot be held accountable for any improvement or deterioration in performance as a whole.

Over the past decade, Scottish economic performance has generally been weaker than that of the UK as a whole. Gross value added—GVA—has grown at a slower rate every year, except in 2002. The gap between Scottish GVA per head and UK GVA per head has widened. However, that comparison is heavily influenced by the performance of London and the south-east. It is important to stress that Scotland's GVA per head is higher when compared with most other parts of the UK.

It should be noted that economic performance in Scotland varies widely. Wealth generation is concentrated in the three largest cities—Glasgow, Aberdeen and Edinburgh—and to a lesser extent in Dundee and other urban communities. Scottish Enterprise's thinking is evolving to reflect that. Its city regions approach seeks to identify how surrounding areas can contribute to and benefit from the growth of the major conurbations and cities.

Let me turn to performance information. The economic environment sets the challenges in context for Scottish Enterprise. However, as I outlined in my introduction, it is difficult to assess the extent to which Scottish Enterprise is succeeding in addressing the challenges that it faces. In "A Smart, Successful Scotland", the Scottish Executive set out the key indicators for assessing the performance of Scotland as a whole, but there is as yet only limited evidence to show the contribution that Scottish Enterprise is making towards achieving the goals.

The performance information that is published in Scottish Enterprise's annual report is limited and focuses on the activities and outputs of the organisation rather than on the impact of its activities. The annual report provides qualitative comment on the previous year's performance and quantitative analysis that focuses on 10 progress measures that are based around activities and outputs, such as the number of business starts assisted or the number of people achieving positive outcomes from training programmes. In the operating plan, target ranges are set for each of those 10 progress measures. Clearly, that type of performance information is important, but it tells us little about Scottish Enterprise's impact on the economy.

A much wider range of performance information is collected by Scottish Enterprise internally and is used to inform management and guide decision making. In addition, Scottish Enterprise uses a balanced scorecard approach to provide a rounded view of the organisation's performance in respect of four perspectives: processes, customers, people and stakeholders. However, the information remains predominantly activity and output based; it does not give a comprehensive picture of Scottish Enterprise's impact or of how the organisation is contributing to the goals of "A Smart, Successful Scotland".

In the field of economic development, measuring impact requires in-depth evaluation of projects and programmes. Scottish Enterprise undertakes an extensive programme of evaluation activity, but not in a way that allows overall impact to be regularly assessed. Attempts to measure overall impact have been infrequent and highly approximate. The previous such attempt resulted in an estimate that Scottish Enterprise's activities in 2001-02 generated additional gross domestic product in Scotland of some £1.6 billion over three years. I should emphasise that that is Scottish Enterprise's own estimate; it has not been subjected to audit and is probably very approximate. The exercise highlighted the considerable difficulties and costs involved in making such assessments. No further attempts have been made. The current focus is on improving the quality of the evaluation evidence that forms the building blocks for such overall estimates.

Scottish Enterprise is by no means alone in struggling with such concepts. We undertook an international review as part of our study and failed to identify any simple solution to the problem of measuring impact in the field of economic development. We concluded that Scottish Enterprise's approach appeared to be as well advanced as that in any other country that we considered.

There have been positive changes in Scottish Enterprise, a number of which relate to the way in which Scottish Enterprise develops, monitors and evaluates its activities. That work continues. A new system known as the gateway process was introduced in September 2003. It provides a clearly structured and rigorous approach to the appraisal, approval, monitoring and evaluation of projects. As part of our study, we reviewed those stages for a small sample of the projects being undertaken by Scottish Enterprise. We identified some weaknesses at all stages. We found a lack of factual evidence to support the rationale for projects, and that the consideration of other options was insufficient. We also found a limited monitoring of outcomes and a lack of consideration of value for money or additional impact. Scottish Enterprise expects that the gateway process will help both to introduce much greater rigour to the process of developing activities and to improve the strategic focus of its activities.

In view of recent suggestions in the media about overspends in Scottish Enterprise, I will at this point mention a section of our report that relates to how resources are allocated. Until this year, budgets were allocated to each broad theme at the start of the financial year. They were then broken down into individual local enterprise companies. That might have given LECs an incentive to spend up to their budget allocation, with a risk of some projects being selected to achieve a spend level rather than being chosen on the basis of the economic justification of strategic fit.

In 2005-06, Scottish Enterprise introduced a major change in the way in which it allocates funds to projects. Budgets have not been allocated in advance, either by theme or by geographical area. Instead, project staff apply for funds as project proposals are approved during the course of the year. Applications are reviewed throughout the year and approved or rejected following review. There is no set budget limit for specific areas of activity. Financial control relies on robust forecasting, and strategic alignment relies on quarterly management reviews. I say in the report that that rolling system should help to ensure that projects are driven by economic justification rather than by a desire to spend up to budget limits. As a result, the selected projects should more closely reflect the ultimate objectives and strategic intent of the organisation, provided that the appraisal and approval system works effectively.

10:15

However, last year was the first financial year in which that approach has been used and, as my report says, management reports to the Scottish Enterprise board suggest that demand exceeded available resources. When the report was produced, it was too early to comment on the effectiveness of management action to contain expenditure, but audited accounts, accompanied by the final auditor's report, will of course be available later this year.

Scottish Enterprise appreciates the need for better quality and consistency in the evaluation evidence that it gathers. The emphasis is shifting towards broader and more strategic evaluations that focus on the impact on GVA, which should help in assessing Scottish Enterprise's overall impact. If used effectively, better and more consistent evaluation evidence should help to ensure that resources are directed at achieving the greatest impact. However, it is too early to judge whether those changes will have the desired effects.

Several other changes, which are designed to improve performance management in the organisation as a whole, are also worth highlighting. I draw the committee's attention to exhibit 31 on page 39 of the report, which summarises the changes. I will describe some of the changes. First, a customer relationship management system has been introduced, which will help to track business customers over time and provide important information for assessing performance and impact. Secondly, Scottish Enterprise is rationalising the range of products that it offers, which should help to sharpen the strategic focus of activities and make it easier to assess impact. Finally, a new strategic focus has been placed on key industries and metropolitan areas, which should also help in identifying where the maximum impact can be achieved.

I suggest that those changes are to be welcomed. They should form a basis for improved performance management in Scottish Enterprise and provide a clearer picture of the impact that it is having. However, as the committee well knows, Scottish Enterprise is a large and dispersed organisation. There is some way to go before staff throughout the organisation are fully cognisant of the positive role of performance management in driving the business.

As ever, the team from Audit Scotland and I are happy to answer any questions.

Margaret Jamieson (Kilmarnock and Loudoun) (Lab): I will pick up the last point about people outwith Atlantic Quay grasping performance management. Did you find evidence of buy-in from people who operate outwith the centre?

Mr Black: We did not examine that in great detail. As I said, the team formed the general view as it produced the report that there was still work to be done in the 12 local enterprise companies to achieve a full buy-in for the new arrangements. The new project appraisal system is significantly different from the previous system, so changes will be needed in the local enterprise companies to address management of that system.

Margaret Jamieson: What you say suggests that Scottish Enterprise is pursuing a top-down rather than bottom-up approach. That links into your point that local enterprise companies receive only core funding and all decisions are centralised at Scottish Enterprise. Given my stated opposition to focusing on metropolitan areas, I am obviously concerned about that centralisation. When you did your investigation, were you aware that most decisions were taken without local support or local knowledge and could therefore have produced the financial crisis that Scottish Enterprise is supposed to be in?

Mr Black: Unfortunately, I cannot help you with a robust answer, because that issue was not examined in detail.

It might be helpful if I summarised our understanding of what is involved in the approval process. The process differs depending on the nature of the project. Large national projects are reviewed by the Scottish Enterprise board, while larger projects that are specific to the LECs are considered by the LEC boards. Very small projects do not require board approval. There is a hierarchy of decision making. In the paper, we comment on the importance of the boards effectively reviewing projects and challenging them at an appropriate level.

Mrs Mary Mulligan (Linlithgow) (Lab): My question follows on from Margaret Jamieson's questions. I recognise what you have said about how resource allocation is changing. Would you like to comment further on the present system of 12 LECs and the change that will make it more metropolitan focused? In your view, did the present system help or hinder delivery and the attempt to meet targets? Do you see a variation in economic performance between Scotland's regions? Did your investigations indicate whether such a variation was influenced by local business and economic factors or whether it was related to the management and delivery of particular LECs?

Mr Black: The move towards a new, more centralised set of arrangements is really a matter of policy, so it is difficult for me to comment on that. You asked about the relationship between local economic performance and the performance of LECs. I cannot recall the detail of that, although my team may be able to help me. However, the early report that I produced included evidence of significant variations in what one might call the application of resources by LECs to different projects. There was a diversity that was not fully explained by Scottish Enterprise's strategy. In part, that has led to the new arrangements for evaluating big projects at the centre, to ensure that there is consistency and a clear assessment of the added value that is expected to come from individual projects.

Exhibit 12 on page 15 of the report shows the estimated GVA per head at LEC level. Clearly, the major conurbations are showing higher levels of GVA per head than other regions. We would expect that, given the metropolitan nature of the Glasgow and Lothian economies. We could not make a direct link between the activities of LECs and GVA per head.

Mrs Mulligan: I was not sure whether the differences shown in exhibit 12 were due to local circumstances or the additional value provided by Scottish Enterprise. Was there any indication of interaction between LECs? You spoke about the centre being able to assess projects across the board, because the information is comparable. Was there any indication of LECs interacting to learn best practice or to share experiences?

Bob Leishman (Audit Scotland): As part of the changes to Scottish Enterprise's performance management, over the past 12 or 18 months it has set up a number of groups that bring together individual members of LEC teams, with the purpose of sharing best practice in a way that had not been done before.

Mr Andrew Welsh (Angus) (SNP): The overall nature of the situation is complex, as is the Scottish Enterprise solution. Mr Black described a hierarchy of decision making at Scottish Enterprise and said that it is a "large and dispersed organisation". What restructuring is envisaged? How far advanced is it, and is a timetable attached?

Bob Leishman: My understanding is that the restructuring is no more than a proposal. I do not think that Scottish Enterprise has finalised that proposal. There have been a number of suggestions over the past months about restructuring local enterprise companies, but nothing concrete has emerged yet.

Mr Welsh: So there will be continuing complexity and dispersal of decision making until that takes place.

Bob Leishman: Yes.

Mr Welsh: Is Scotland in an exceptional situation or are comparators available? In other words, can you point to successful models for such a complex situation elsewhere?

Bob Leishman: Our international review did not find any country that could clearly demonstrate the benefit of economic development and its impact on an economy. We have highlighted in the report a couple of examples of countries that we felt had better information. Canada, for example, made much more use of modelling to track the impact of economic development. Ireland uses a longitudinal survey of assisted companies to get a picture of the impact of its assistance over time. Those are the kind of areas in which Scottish Enterprise might learn a bit, but no one has the answer to that question.

Mr Welsh: Mr Black, you said that it is difficult to assess whether Scottish Enterprise is contributing to the goals of "A Smart, Successful Scotland". Are there in-house assessment and performance measures or is outside assistance available to solve those problems?

Mr Black: In answering that question, it might be helpful if I were to ask the committee to bear in mind a series of exhibits between pages 24 and 27 of the report, which attempt to capture the performance targets that have been put in place at different levels. It is a complex read. One of the main findings of the report is that it is quite difficult to relate some of the more detailed objectives back to the high-level objectives of "A Smart, Successful Scotland". We suggest that more probably needs to be done to try to relate the activity of Scottish Enterprise to the Scottish Executive's high-level goals. The exhibits highlight the fact that Scottish Enterprise has a number of measures of its own activities that are not reflected in its annual report. In particular, the organisation uses a balanced scorecard—captured at exhibit 23—that is essentially designed to capture information on four dimensions: what its stakeholders are looking for; how good its processes are; what its customers are looking for; and issues to do with its people. The latter is entirely appropriate. We have included some examples of the information that is collected.

However, a great deal of that information is not translated into the annual report, which tends to discuss activities that have taken place during the previous year. We wonder whether Scottish Enterprise could do more to join up some of the information that is gathered and the evaluation that takes place in the organisation in a more effective way that would mean more for stakeholders such as the Parliament.

Mr Welsh: Is the essential problem that we are trying to get focus out of what is obviously a complex situation? Is there a case for reconsidering those high-level objectives for the purposes of revision and clarification, which in turn may help Scottish Enterprise to focus?

Mr Black: There is good joint working between the Scottish Executive and Scottish Enterprise to monitor progress against Executive targets, but on the basis of our analysis we suggest that more needs to be done.

10:30

Susan Deacon (Edinburgh East and Musselburgh) (Lab): At the beginning of his report, the Auditor General set out the genesis of this work and the background to it. Years ago, through this committee, some of us were involved in that. It is, therefore, simply coincidental that this report has appeared at a time when parallel discussions are taking place about Scottish Enterprise. As a member of the Enterprise and Culture Committee, which is considering current issues that have arisen, I plead that we exercise a little joined-up thinking and ensure that this committee's deliberations and the work that Audit Scotland undertakes be fed into the discussions that the Enterprise and Culture Committee will have over the coming weeks.

At this point, I will exercise a little joined-up thinking myself and, remembering which committee I am in at the moment, move to my questions. For the avoidance of doubt, are you saying that, having conducted international comparisons, you believe that although there is scope for improvement Scottish Enterprise's system of performance management broadly compares favourably with that of equivalent agencies elsewhere?

Mr Black: That is a reasonable summary of the situation. Scottish Enterprise's thinking about how to evaluate impact is as advanced as that of any agency that our study examined.

Susan Deacon: That is helpful.

Would it be a fair summary of your report and your comments today to say that you believe that the new system for project appraisal is, as you say in your report, a "potentially helpful development"? In other words, regardless of the problems that have arisen this year with the operation of the system, is it your general view that the direction of travel in relation to project appraisal in the agency is good and that that approach should continue and be improved on?

Mr Black: That is a fair summary. The phrase "direction of travel" is appropriate in this context because the situation is dynamic. It was only in 2005-06—the financial year that has just ended—that Scottish Enterprise introduced its new system for allocating funds. It is therefore at an early stage. As I outlined, the new system is designed to ensure that any significant projects that come forward for approval are evaluated robustly in order to demonstrate the added value that they should bring. We believe, however, that Scottish Enterprise has some way to go before it beds that down, not least in relation to the quality of management information that we have available.

Susan Deacon: I note that you have talked about some areas that could be improved, which is precisely the sort of information that could feed in usefully to discussions elsewhere.

The overspend that has arisen this year—it has been suggested that it is about £30 million—has been widely talked about in recent weeks. I do not want to lead you into an inappropriate area, but words such as "financial crisis" are bandied about frequently in the world in which we live. You examine financial situations in every public sector body across Scotland. Can you benchmark SE's current financial situation for us and tell us how significant it is? How does the figure of £30 million compare with the organisation's overall budget?

Mr Black: I am not sure that I can do that directly and you will be aware that I am reluctant to say too much until I have the audited accounts and the report of the auditor.

However, I can say two things. First, for as long as I can remember, two features of public expenditure on major projects have been that big budgets tend to be underspent and there tends to be slippage in programmes. It is therefore entirely appropriate for bodies such as Scottish Enterprise to try to find ways to keep the programme up to the mark in terms of a spend profile that matches the resource allocation. That carries the risk that it might at the year end incur an overspend within one financial year. However, that is not the same as suggesting that there is a fundamental problem with financial control, taking one year with another. I hope that, when we get the auditor's report on the audited accounts, I will have more information to give the committee about the true extent of the underlying problem.

Susan Deacon: That is helpful. Thank you.

My final question is on the structure of the organisation. I think that I am correct in saying that you produced your report before the minister made a statement to Parliament on the issue. It was therefore written when the direction of structural travel in the organisation was towards a metropolitan region arrangement. Subsequently, ministers said that they will retain 12 local enterprise companies.

Again, without commenting on the policy decisions, will you say how that latest development will impact on the issues that you raise in your report, including the point that Andrew Welsh mentioned about the complexity of the organisation? You state that the organisation is "large and dispersed" and you link that to difficulties in effective performance management throughout the organisation. Given that the decision to retain 12 LECs was taken after your report was published, how might your observations change in the light of that subsequent decision?

Mr Black: I am not sure that I can answer that question terribly well because our understanding of Scottish Enterprise's intentions for its reorganisation is quite limited. The question should be addressed primarily to the management of Scottish Enterprise.

The Convener: When might we expect the audited accounts to come before the committee?

Mr Black: The planning timeframe is that the audited accounts should be available in September. The final audit report normally follows a while after that, so I suggest that it will be October or November before I am in a position to prepare for the committee a report that will be based on the audited accounts. I will decide whether to prepare a section 22 report when the full facts are available from the auditor.

The Convener: So we will not get that report until after September.

Mr Black: It will be a good while after the summer.

The Convener: I refer to paper EC/S2/06/05/1, which is a summary of your report. It states:

> "Key findings include that:
>
> • The performance measurements used by Scottish Enterprise provide a limited picture of the agency's achievements and focus on activities and outputs, rather than impact.
>
> • The Scottish Executive monitor progress towards the ambitions set out in A Smart Successful Scotland, but it is difficult to assess well the contribution that Scottish Enterprise is making towards these goals.
>
> • The evaluation evidence available to assess the impact of Scottish Enterprise's activities is of variable quality and the methodologies used lack consistency."

Although Scottish Enterprise might compare favourably with other agencies internationally, is it fair to say that there is a general lack of information that allows a conclusion to be made about the agency's impact?

Mr Black: It is fair to say that there is a lack of publicly available information and that the evaluation evidence within Scottish Enterprise is variable in its quality and coverage. It is also fair to say that the management of Scottish Enterprise is aware of that and is working to improve the situation. There is evidence for that, first, in the balanced scorecard framework that it is developing, which is summarised in exhibit 23 on page 27, and secondly in the exhibit on page 39, which summarises the changes that are under way within Scottish Enterprise. In that exhibit, we list some of the changes that the organisation is introducing that will help to improve performance management. All are significant steps in the right direction.

The Convener: We will have an opportunity to discuss the report under agenda item 4. Do members wish to raise any points now?

Mr Welsh: The report states:

> "Changes to the systems for project appraisal, approval, monitoring and evaluation should help focus activities on the impact that can be achieved and deliver better performance information."

The changes are helping, but how effective are they? How and when will we know whether the changes have worked? What is the gestation period?

Mr Black: That question is probably best put to the management of Scottish Enterprise. Do the team have any information to add to that?

Bob Leishman: Not a lot. That would need to be followed up. We are talking about systems that have been introduced in the past 18 months to two years, which will take two or three years to bed in. You would need to evaluate their success as a specific exercise. We expect Scottish Enterprise's management to evaluate the changes on an ongoing basis.

"Council housing transfers"

10:41

The Convener: Item 3 is a briefing from the Auditor General on his report "Council housing transfers".

Mr Black: The report is about management of, and value for money in, a key part of the Executive's housing programme. In the report, we consider council's transfer of large numbers of houses that they own to alternative not-for-profit landlords. Since 1998, councils have transferred more than 100,000 houses to new landlords. Three councils transferred their entire stock in 2003, including Glasgow City Council, which transferred 80,000 houses.

Between 2006 and 2007 six more councils will, if everything goes to plan, transfer another 50,000 or so houses. My report concentrates mainly on the earlier transfers, although we also refer to some of the more recent activity.

The report is very full and contains a lot of detailed analysis of the implementation of the complex transfer policy. All that I can do today is summarise some of the main messages. The team and I will attempt to answer questions.

I will describe briefly the main findings, many of which are positive. The main message is that tenants are seeing benefits from the transfer, but there are important qualifications to that. Although management of transfers is improving, the planning and implementation of the earlier transfers could have been stronger. Better and clearer measures are needed to assess value for money.

The report is divided into three parts: the first part provides the context and concerns the basis of the housing transfer policy; the second part considers how well the transfers have been implemented; and the third part is about transfers and value for money.

I will first say a brief word about the basis of the transfer policy. Transfers are designed to increase investment in housing, improve efficiency and increase tenant control. High levels of debt have constrained councils' ability to invest in housing, and council surveys indicate that £7.5 billion is needed to improve the current housing.

For councils that have transferred all their housing, the Treasury has repaid £1.3 billion of historical housing debt. The chart on page 7 of the report highlights the relationship between housing debt and rent income for the 29 councils that still retain their housing stock. Many, if not all, councils with higher debt are now pursuing transfer; repayment of historical debt is a major incentive for them.

Transfer is not just a financial consideration. Transfers are expected to encourage community ownership, which means that they should also bring additional wider benefits such as better services and more effective housing management and should, ultimately, contribute to community regeneration. From a policy perspective, those additional benefits justify the debt repayment for any council that elects to transfer its houses to another landlord.

10:45

Although the management of transfers is improving, the Executive's guidance for the first round of transfers did not provide a good route map to assist the process. The workload proved to be significantly greater than had been forecast and the first transfers took an average of three and a half years to complete. Incentives to control the substantial transaction costs, which amounted to £59 million for the first transfer, were limited and there was no pilot work to help the planning and implementation of the first transfers.

The Executive stated clearly that its priority was to tackle Glasgow, which had the most extreme housing problems. Given the size of that transfer, a question that is raised by my report is whether some of the £43 million transaction costs for the Glasgow transfer could have been reduced if other smaller transfers had been completed first and lessons learned from them. We have to acknowledge that the transfer process is complex; we have attempted to summarise that in exhibit 8, on page 13. Although there was review and challenge of the costs, the Executive did not use clearly defined gateways with financial limits to control the total costs of the big Glasgow transfer.

At certain key stages of the transfer—in 2002 and 2003—it was necessary for the Executive to agree significant financial changes, including a grant of £409 million to support the business plan of the Glasgow Housing Association in its first 10 years. On page 17, exhibit 12 summarises the main changes that affected the level of grant to the new landlord in Glasgow. However, lessons have been learned and the overall management of transfers is improving. The Executive now has much better guidance and better financial controls that are founded on a clear gateway process, and new national standards and targets about housing quality are now in place. The gateway process is summarised on page 21, at exhibit 16.

The third part of the report examines value for money. The report provides some assurance that the desired outcomes from transfers, such as increased investment and rent guarantees, are being provided. However, it provides a more qualified assessment about greater tenant control and it questions the value-for-money assessment process that is used by the Executive. On investment, the seven completed transfers that are examined in the report will result in some £3.2 billion of improvements to homes over the next 30 years. In most cases, the investment in the next 10 years will be significantly more than the predecessor council spent since local government reorganisation in 1996. Rents will rise by 1 per cent a year or less in real terms, compared with average rises of 3 per cent a year in real terms under council ownership.

The report states that transfers have promoted greater tenant control, but more can be done. Tenants now make up at least a third of the governing bodies of the new landlords, but different approaches to tenant involvement have been developed. More than half the tenant groups that responded to an Audit Scotland survey said that the transfers have produced a big improvement in participation, but a quarter of groups reported that they have seen no difference and one in 10 said that the situation has worsened. In each case, transfer plans have been subject to significant scrutiny, and there is evidence that the new landlords are performing as required.

The report asks questions about the Executive's value-for-money assessments of the early transfers. On the specific aims of improving housing management and creating area regeneration, there is no systematic evidence to indicate what the performance level is. In the report, we say that better and clearer measures are needed to assess impact and value for money. In the first three whole stock transfers, the Scottish Executive team reviewed and challenged the landlords' projected costs, but there was no systematic review and the Executive did not set performance indicators to assess efficiency.

On page 41, exhibit 30 shows the main costs of the seven completed transfers; the general impression that we have formed is that the new landlords seem to have adopted relatively high-cost business structures. For example, the Glasgow Housing Association, which is by far the biggest, had management costs of more than £1,000 per home in 2003-04, with a 30-year forecast of an average of £834 per house.

There is a lot more analysis and information in the report than I have been able to cover in my brief introduction. For example, in appendix 4 on page 58, there are eight case studies of the transfer process, which contain a lot of detailed information about Glasgow in particular. As ever, my colleagues and I will be happy to answer questions. I am pleased to say that Dick Gill is steeped in the report, so I shall be relying heavily on him when we get into some of the more detailed questions on what is really quite a substantial piece of work.

Mr Welsh: You say in the public paper:

> "Without assurance from competition and in the absence of targets or outcome measures … it is difficult to be sure that terms for the initial housing transfers provide the best possible value for money."

Who is responsible for producing those "targets or outcome measures"?

Mr Black: The Scottish Executive is responsible for setting out the terms for implementing the policy.

Mr Welsh: You also recommend new and better measures for quality performance and tenant involvement. Who will produce those measures and what will be the timetable for that? Do such measures exist anywhere else?

Dick Gill (Audit Scotland): As responsibility for the policy rests with the Executive, it will be responsible for taking forward the report's recommendations. However, Communities Scotland has taken over the Executive's role in managing the transfer process and has a wider inspection and regulation role in relation to the housing association sector. As a result, both the Executive and Communities Scotland have important responsibilities in setting better measures.

Mr Welsh: Although tenant participation has improved, 35 per cent of tenants feel that they are no better off or are worse off under the new system. How is that being addressed?

Mr Black: You will need to ask the Executive that question. As our report says, there has been a variety of approaches to tenant involvement, some of which seem to have been more successful than others. I hope that one benefit of this full and detailed analysis will be that Communities Scotland and other organisations that are in charge of implementing the policy will examine in more detail the practices that are working well with a view to emulating and developing them in other areas.

Dick Gill: I point out that from page 41 on in part 3 of the report, there is a lengthy discussion about the monitoring arrangements for houses that are subject to transfer.

As far as tenant participation is concerned, we felt that it was important to understand the customer's perspective. We did not find much good evidence either from the Executive or from the regulator, Communities Scotland, on how transfer had improved tenant control, so we carried out a tenant survey to get a handle on that. Most respondents felt that transfer had on the whole improved participation and control. However, as you have pointed out, because not all tenants felt the same, we have recommended that Communities Scotland and the Executive try to get a better handle on that important dimension of the transfer policy.

Mrs Mulligan: Has tenant participation gone no further than simply putting tenants on various boards?

Mr Black: Such an impression would be seriously misleading. As the report points out, things are working very well in many areas. However, a detailed look highlights the diversity of approaches to governance arrangements, for example. In some areas the arrangements are working well but in others there is scope for improvement. Because people who are involved in the oversight of new housing bodies come from different backgrounds—they might be council or tenants representatives or independent members—one of the biggest challenges is to get them to work as a team in the housing association's interests. I am sure that Communities Scotland will monitor the situation closely and assist in developing good practice.

Dick Gill: Our report points out that tenant participation is more than simply getting tenants on the board. As Bob Black made clear, it is not fair to say that that has been the only achievement.

Our difficulty is that although there is a quite a lot of different evidence about what has been achieved, it is hard to generalise and there is a lack of objective data. One of the recommendations in the report is that the Executive should think about additional benchmarks or measures. We talk specifically about measurement of quality of service, and about tenant involvement and empowerment. The way to get evidence on those is to ask tenants what they think and to publish the results. Although there is some evidence from surveys of tenants, there is no systematic picture of how tenants are responding to stock transfer, although there is some evidence that there is frustration among some tenant groups about the amount of participation.

Mrs Mulligan: I am pleased to hear that my summary was not correct and that tenant participation has gone further than that.

My substantive question is about the role of Communities Scotland and its involvement in developing the gateway process, setting targets and monitoring and assisting with the development of the local housing associations. Will you say a little bit more about that?

Dick Gill: Communities Scotland and the Executive need to work together in that area. If the committee wanted to take further evidence on that, it could explore it with both those bodies.

Communities Scotland has a role in supporting implementation of the policy, but the Executive owns the policy. Some of the wider policy goals—tenant participation, tenant control, and community regeneration—are important policy objectives for the Executive. Part 3 of the report mentions the need for evaluation and it is clear to us that the Executive, as the owner of the policy, will need to do the evaluation process. The Executive must do a little bit more work on that.

Mrs Mulligan: The committee might consider that area further.

Susan Deacon: I would like to pick up where Mary Mulligan has left off. I am interested in what you and the report say about tenant participation. I agree absolutely with the need to go beyond the involvement of tenants organisations and to use good, well-established market research techniques to find out what tenants think. I have listened to everything that you have said about that in response to Mary Mulligan's questions.

On the question of where to go from here and how to make that happen, you just said that the Executive, as the owner of the policy, should do more to evaluate what tenants think. I worry that you are saying that the Executive should be prescriptive in some sense. I presume that you do not really recommend that the Executive should facilitate that kind of practice at a local level. Will you clarify what you mean for the *Official Report*? I know that your report says more about the matter, but I hate to think that we are moving towards a top-down, written-guidance type of approach.

Dick Gill: It is quite a complex area to deal with. Part 1 of the report sets out the housing transfer policy and it explains that housing transfer is important because it enables additional investment. Clearly, that is working. However, the report also says that there are wider objectives such as tenant control and participation and community regeneration.

The value for money question is about the balance between the resources that are going into housing transfer—in Glasgow, significant public resources are being put in to support the transfer process—and where the value comes from those resources. Part of the answer is that the value comes from the additional investment that is facilitated by the transfer, but it is more than simply an accounting device. What are the other benefits to the taxpayer from all the funding that is being put into the transfer? The answer to that has to be given in terms of the broad goals of tenant control and participation, improved housing management and community regeneration.

It seems to us that it is important that the Executive, as the owner of the policy and the organisation that has committed those public resources, can give a good and convincing answer to those questions. We are not saying that those benefits have not materialised. We are saying that we are not clear about how far they have materialised and that it is important—in terms of public policy making and accountability—that there is clarity about them.

I do not think that we are trying to take a top-down approach. The big transfers took place in 2003. We are now in 2006 and there are at least another six or seven big transfers to go through this year and next year. We need to be able to answer the question, "Are they working as well as they should be?"

11:00

Susan Deacon: Thank you.

Auditor General, you said earlier that one of your main conclusions is that there are—I think I quote directly—relatively high-cost business structures in place. Will you elaborate on that? Are you in a position to make any observations about whether the relative costs of those structures are related to the quality of management?

Mr Black: I invite Dick Gill to offer additional comments, but our analysis of the matter is captured in exhibit 30 on page 41. The exhibit shows the 30-year forecast costs for the seven completed housing transfers and gives the costs per home. For the Glasgow whole housing transfer, there are high forecast management costs over the next 30 years. As I think I said, the actual cost in the first year was more than £1,000 per home. We suggest that the area needs careful analysis.

Exhibit 29, on the preceding page, shows how the costs break down. Some 46 per cent is capital investment, but management accounts for 25 per cent, so a significant proportion of the total moneys is being spent on management costs. It strikes us that those costs seem rather high, to say the least.

Dick Gill: The 30-year forecast costs in exhibit 30 show that the management and other running costs in Glasgow amount to £834 per home per year. The question is whether that is reasonable. Exhibit 31 gives some statistics that Communities Scotland publishes on median, lower quartile and upper quartile management and maintenance costs for the 170 or so registered social landlords in Scotland. Those figures are rather lower than the Glasgow figure. The lowest line in the table in exhibit 30 shows a median cost of £693 per unit per year. That is the current cost, whereas the figure for Glasgow is an average over 30 years and, at the moment, the actual cost is higher than the average.

It is clear to us that Glasgow's costs are relatively high, but it is difficult to say whether there are good reasons for that. There are certainly some reasons why Glasgow would have higher costs than others and we mention some of those in the report. For example, just over 20,000 of the 70,000 or so houses that were transferred to the Glasgow Housing Association are multistorey flats that have a concierge service for security and other reasons. That adds to the costs.

We have not been able to say that, in the transfer process, Communities Scotland and the Executive got the best possible deal with the GHA in relation to its management costs. It is also important to say that the Executive and Communities Scotland now have a much stronger approach to benchmarking costs as part of housing stock transfer. They now have something called a pricing model and their objective is to approve transfers only when the management costs are seen to be comparable—at least in the lower quartile, I think—with those of the wider housing association movement.

The evidence is not clear, but it looks as though Glasgow has relatively high costs. That is something for the committee to explore—if it wishes to—in its evidence-taking session with the Executive and Communities Scotland.

Susan Deacon: So it would be fair to say that we ought not to read too much into the actual level of costs but that there is more work to be done to find out whether the costs are reflected in the quality of the job that is being done. That is something that we need to probe further.

Dick Gill: Our top-down view is that one of the policy justifications for transfers is improved management of housing. The obvious question for us is whether that means more efficiency in managing the units. Our difficulty is that although the costs seem to be reducing under transfer, we are not necessarily confident that the reduction has gone as far as it could have. Glasgow is such a big case that it is important that the hard questions are answered.

Susan Deacon: I want clarification on one final point. Am I right in saying that this is the first thorough report that has been done on the policy?

Dick Gill: In Scotland, yes.

Susan Deacon: That was my understanding. It is important that we understand that, in contrast with some issues on which the committee has spent a considerable amount of time and on which there have been numerous reports, the report is at the leading edge in giving us an overview of a relatively recent policy.

Margaret Jamieson: I will continue on the theme of management costs. Do we have information about the pre-transfer management costs in each case? That is necessary to ensure that we are comparing like with like.

Dick Gill: We asked the question, but I am afraid that we could not get a good answer. There are no baseline data to compare, which is a shortcoming in the arrangement.

Margaret Jamieson: That is a significant shortcoming. An awful lot of lessons have been learned, but is there information that indicates that those are being taken on board for the next lot of transfers this year and next?

Dick Gill: We know that the Executive has now produced much better guidance. Although we have said that the management of the earlier transfers could have been improved, we have balanced that by saying that the Executive introduced much stronger guidance in 2004. Our difficulty is that that guidance applied only from 2004 or early 2005 and none of the transfers that are currently being conducted under that guidance has come to fruition. We cannot audit what has not yet happened.

We considered the Edinburgh stock transfer because we thought that we could not ignore the new transfers. The process provided some assurance that the new transfers were being helpful in that they were, for example, bringing down transaction costs and producing a slightly more rapid transfer process. However, the Edinburgh transfer did not get through the tenant ballot, so it is hard to give a definitive answer. Do those comments answer your question?

Margaret Jamieson: Yes.

My other concern is about tenant involvement and empowerment. Empowerment is the big issue for many of us because involvement can mean that people can just be asked for their views, but it is significant if people are empowered to find out where the money is coming from, how it is being invested and so on. Are you satisfied that sufficient capacity building takes place prior to a transfer and shortly afterwards to ensure that tenants who are involved in the transfer are fully engaged in the process and have as much knowledge as they can about it? Are the bodies involved examining what is done by other organisations, such as RSLs—some of which are very good at this and some of which are getting there—and picking up best practice.

Mr Black: We cover the matter in the report from page 29 onwards. Exhibit 22 might be helpful as it summarises the requirements for effective tenant participation. The issues to which it refers echo those raised in Margaret Jamieson's question. Those include the importance of

"Adequate resources and support for tenants"

in addition to

"Good leadership … Excellent communication"

and

"Early involvement".

It also refers to the need to have an effective communication strategy and the importance of the process being linked into community improvements.

On the next page, there is some analysis of what happened. One of the interesting points is that tenants certainly seemed to engage well in the process. In each of the transfer ballots, the turnout of tenants was higher than that achieved in the local government elections. As I am a former local government official, that point interested me enormously.

There is a section in the report on how transfers have increased the scope for tenant control, although there is more to be achieved. I invite Dick Gill to summarise the key findings.

Dick Gill: I do not think that we can give the committee a definitive assurance in this area. One reason why we did the survey was that we felt that there was a gap in the evidence on transfer. The question of the quality of tenant participation and empowerment that has been achieved is very much one for Communities Scotland to address as part of its regular inspection of each transfer landlord. From our point of view, one complication is that Communities Scotland has not completed an in-depth inspection visit of a transfer landlord since the transfers were completed. That is why we are raising a question mark. We are not saying that there has not been success in the area of transfer; we are asking whether tenants have got as much as they could or should have under the policy.

Our survey in appendix 2 will give the committee answers to the questions. To take an example more or less at random, paragraph 17 on page 50 refers to a survey question that was about registered tenants organisations' perception of how they influenced housing services. Exhibit 37 on page 51 shows that about 30 per cent of respondents said that they had a lot of influence and 41 per cent said that they had some influence, but 28 per cent said that they felt that they had not much or no influence on housing services. I think that that is a critical finding for tenants in the area in question. The picture is mixed; it is broadly positive but not exclusively so. That is why we think that there must be more scrutiny and better measurement in the transfer area.

Margaret Jamieson: It would have been interesting for us if the figures had been broken down further into findings from those who had transferred, so that we could get an idea of whether there was a geographical issue or whether each transfer was different.

The Convener: Members have no further questions, but I have one. Was a reason given as to why pre-transfer management costs were unavailable? Was it just that they were not kept? Was it too difficult to collate them?

Dick Gill: There are accounting difficulties to do with the allocation of costs. The question is what is meant by management costs. The unfortunate fact is that different councils may have different practices in accounting for their overheads. That is one of the difficulties. It is perfectly possible to go to, for example, Glasgow City Council's accounts and pull out a figure for management costs, but we have no basis for being able to say that those are comparable with the costs that appear under the management costs line in Glasgow Housing Association's published accounts. That sort of difficulty could have been avoided with a little bit of foresight and work. However, the fact is that it was not avoided and we have that accounting problem.

The Convener: Following on from your answer, although information on management accounts is now available for the new management bodies, are the accounts of each body comparable? In other words, do the bodies have similar management measurements in this area?

Dick Gill: Again, I do not think that Communities Scotland prescribes the accounting for management costs; it just collects information about management costs. I am not sure how far it prescribes the content of such costs. On the other hand, Communities Scotland publishes statistics on management costs that are drawn from all 175 RSLs. We put an example of that in the report. There should not be an enormous difference between the costs. One of the reasons why Communities Scotland collects those costs is to ascertain whether there are differences and, if there are, to try to understand why they arise. However, I do not think that Communities Scotland is quite there yet for the analysis of GHA.

11:15

Margaret Jamieson: There is information on each of the local authorities' housing revenue accounts. Would that information have been too crude for measuring management costs?

Dick Gill: The short answer is yes; it is too crude because of the accounting difficulties to which I referred.

Mrs Mulligan: You say that you can give us averages for RSLs' management costs. Are there figures for upper and lower limits?

Dick Gill: Do you mean quartiles, for example, so that the question is whether there are average lower quartiles?

Mrs Mulligan: Yes.

Dick Gill: The report has exactly those statistics. Exhibit 31 on page 42 is more or less a straight extract from the very full volume that Communities Scotland published, with statistics, in this area. That sort of information is available for every RSL in Scotland.

The Convener: I thank the Auditor General and Mr Gill for their evidence, which is helpful. The committee will discuss in private, as the next item on the agenda, its reaction to the briefings on council housing transfers and Scottish Enterprise.

Before we move into private session, I want to take a minute to record the Audit Committee's thanks to Arwel Roberts, who is retiring from Audit Scotland at the end of the month. Arwel has attended the committee's meetings for some time and has provided us with wise counsel, both formally and informally. Another important factor is that he has been good company on many of the visits that we have undertaken to discover more about auditing. I thank Arwel for his time with us and I wish him all the best in his retirement, which I am confident will not be a quiet one.

Arwel Roberts (Audit Scotland): Thank you very much, convener. It has been a pleasure and a privilege to be involved in the committee's work and I will continue to be an observer. Could I, in my turn, give the committee best wishes for the future in what is, after all, very important and influential work?

The Convener: Thank you, Arwel. I suspend the meeting for five minutes before we move into private session.

11:17

Meeting suspended until 11:30 and thereafter continued in private until 12:47.

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