

# **AUDIT COMMITTEE**

Wednesday 27 June 2007

Session 3

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## AUDIT COMMITTEE

### 2<sup>nd</sup> Meeting 2007, Session 3

#### CONVENER

\*Charlie Gordon (Glasgow Cathcart) (Lab)

#### DEPUTY CONVENER

\*Murdo Fraser (Mid Scotland and Fife) (Con)

#### COMMITTEE MEMBERS

\*Willie Coffey (Kilmarnock and Loudoun) (SNP)  
\*Jim Hume (South of Scotland) (LD)  
\*Stuart McMillan (West of Scotland) (SNP)  
\*Mary Mulligan (Linlithgow) (Lab)  
\*Dr Richard Simpson (Mid Scotland and Fife) (Lab)  
\*Andrew Welsh (Angus) (SNP)

#### COMMITTEE SUBSTITUTES

Iain Smith (North East Fife) (LD)  
Sandra White (Glasgow) (SNP)

\*attended

#### THE FOLLOWING ALSO ATTENDED:

Mr Robert Black (Auditor General for Scotland)  
Angela Cullen (Audit Scotland)  
Caroline Gardner (Audit Scotland)  
Graeme Greenhill (Audit Scotland)  
Margaret Smith (Edinburgh West) (LD)

#### CLERK TO THE COMMITTEE

Tracey Hawe

#### SENIOR ASSISTANT CLERK

Joanna Hardy

#### ASSISTANT CLERK

Rebecca Lamb

#### LOCATION

Committee Room 1



## Scottish Parliament

### Audit Committee

*Wednesday 27 June 2007*

[THE CONVENER *opened the meeting at 10:00*]

### Interests

**The Convener (Charlie Gordon):** Good morning. I welcome members of the committee, the press and the public to this meeting of the Scottish Parliament's Audit Committee. I also welcome the Auditor General for Scotland and a galaxy of staff from Audit Scotland, of whom more later. I ask everyone present to ensure that their mobile phones and pagers are switched off. There are no apologies, so we have a full complement.

**The Convener:** Item 1 is declarations of members' interests. The weather's impact on members' travel arrangements last week make it necessary for me to invite Willie Coffey MSP to declare any interests that he might have that are relevant to the work of the committee.

**Willie Coffey (Kilmarnock and Loudoun) (SNP):** I have two interests to declare, as intimated in my entry in the register of members' interests. First, I currently serve as an elected local government councillor on East Ayrshire Council on London Road, Kilmarnock, for which I receive remuneration of between £15,000 and £20,000. Secondly, I own a small number of shares in Kilmarnock Football Club, which I do not believe to be a pecuniary interest but, nevertheless, it is very close to my heart.

**The Convener:** Thank you, Mr Coffey. On the latter item, it rather depends on how much Kilmarnock extract from Rangers for one Mr Naismith.

## Decision on Taking Business in Private

10:01

**The Convener:** Agenda item 2 is to consider whether to take agenda items 6 and 7 in private. It is the norm for such items to be taken in private because, in the case of each item, we could decide to hold an inquiry and, in that case, we would start to discuss who we might call as witnesses, and potential witnesses should hear from the committee before they read it in a newspaper or see it in a written report. However, the issues appear earlier on the agenda, so members will have ample opportunity to ask questions in public. Are we agreed that we will take items 6 and 7 in private?

**Members indicated agreement.**

## Audit Scotland (Annual Report 2006-07 and Work Programme)

10:03

**The Convener:** Agenda item 3 is Audit Scotland's annual report and forward work programme of performance audits for the year ahead. I formally welcome to his first appearance before the committee in the new session of Parliament the Auditor General for Scotland, Mr Black, and his staff. I invite you to brief the committee on your annual report for the year 2006-07 and on Audit Scotland's programme of performance audits for the next year.

**Mr Robert Black (Auditor General for Scotland):** Thank you, convener. I, in turn, welcome you and members of the committee to this new Audit Committee. I congratulate members on their perspicacity in choosing—or perhaps agreeing to serve on—the Audit Committee. As long-serving members will know, this committee receives the richest and most diverse diet of reports, all done to a turn and served up by Audit Scotland, on what is really happening in government—as opposed to what is sometimes reported as happening. We look forward to working with you.

It is fortunate for us that the first substantive item of business is for the committee to receive Audit Scotland's annual report, as it allows us to give you a perception of the work we do, based on what we have done during the past year. The essence of Audit Scotland's role is to prepare reports for the Parliament and local authorities to provide elected representatives—members of the Scottish Parliament and councillors—with objective information to assist them in scrutinising and holding to account everyone and every body that spends public money under the devolved regime in Scotland. We also think, and have demonstrated, that through our work in gathering objective evidence on what works best, we can make a significant contribution to the holding to account agenda and to helping to improve public services.

Audit Scotland is unique, in that it is the only body that looks across the whole of government—the national health service, local government, central Government, all non-departmental public bodies and agencies, the further education sector and so on. We can look—and, over the past few years, have looked—at complex cross-cutting issues such as the youth justice system and the operation of community planning, but we can also follow public money from the centre right through to the point of service delivery, where the money is spent. We sometimes use the phrase “following the public pound”.

As we say in the introduction to our annual report, we have tried to give the committee an insight into the full range of our work and the breadth and depth of our activities across the public services. We remain committed to delivering our twin aims of holding public bodies to account and helping them to improve. We oversee 200 public bodies in Scotland that, together, spend £29 billion—a very significant sum.

In the past year, we submitted to the Parliament a total of 21 reports, including four cross-cutting reports of the type I mentioned, four reports on the performance of the NHS and nine reports related to the accounts of public bodies. All the reports came to the Audit Committee in the first instance. We produced nine best-value reports on local authorities and four local government performance reports. Those 13 reports are considered primarily by the Accounts Commission for Scotland.

By far the greatest number of reports go to the audited bodies. A total of 195 reports were delivered to individual spending bodies—councils, NHS boards and so on—at the conclusion of each of their local audits. In appendix 3 to the annual report, from page 27 onwards, we highlight all the public performance reports that we made last year. I will mention briefly two major reports that were submitted to Parliament during the previous session but that the Audit Committee did not have time to consider. One of those reports—our overview of the performance of the transport sector in Scotland—is rather topical. We looked comprehensively at all spending programmes in the transport sector. The other report on which the previous Audit Committee was unable to take evidence in the time available to it was a comprehensive examination of the management of information technology to deliver information in the NHS in Scotland.

I am aware of the time pressure to which the committee is subject and that it has a full agenda. I am happy to answer questions on the annual report, to come back on a future occasion or to contribute to any seminar that the committee may hold during the recess. Our annual report is also submitted to the Scottish Commission for Public Audit, which, on behalf of Parliament, formally oversees our budget and spending. It will no doubt consider the report at one of its meetings.

Caroline Gardner has kindly agreed to introduce our forward programme of studies, which may be of immediate interest to members.

**The Convener:** I invite members to ask questions about the annual report.

**Dr Richard Simpson (Mid Scotland and Fife) (Lab):** I congratulate Audit Scotland on its efficiency savings and redirected costs, which seem impressive, but why have the charges for

further education audits gone up when all other charges have been reduced?

My other question is more general. In the report you refer—as you do in many of your reports—to good practice. The most important part of the process is to ensure that good practice is spread uniformly. Beyond making a report, what role do you play in spreading good practice? Do you have any function in that regard, or is it a matter for the Government and for Parliament? If you have such a function, has there ever been an audit of whether good practice is spread adequately?

**Mr Black:** I will take the second question first. The impact of our work is an issue of growing concern to Audit Scotland as our competence and the range of work we deliver increases. When we do major pieces of work, we attempt as a matter of routine to capture what seems to work best. Our reports are populated with exhibits and examples of what works best, which we attempt to encourage the public sector to take on board.

Secondly, we quite often—and increasingly so—produce material that is directed towards, for example, board members on national health service bodies so that they can follow through any action. We expect the appointed auditors of individual bodies to seize on key recommendations and to encourage boards and public bodies to implement them.

Thirdly, some pieces of work are tailored more towards helping an organisation to improve than to holding it to account. For example, we recently did a major piece of work in partnership with the audit agencies elsewhere in the United Kingdom as a contribution to the efficient government programme. We considered the costs of corporate services and benchmarked indicators that could be applied to corporate services throughout the public sector. We are encouraging the public sector to adopt those indicators.

Finally, we contribute to seminars and workshops on best practice. We participate in such activity throughout the public sector without compromising our independence. Much of that activity does not necessarily come to the attention of the Parliament.

Caroline Gardner will respond to the question about audit costs in further education.

**Caroline Gardner (Audit Scotland):** In broad terms, there are two points to make. First, the fees for all audits are agreed between the audited body and their auditors, within a band that is approved by Audit Scotland, to ensure that they reflect the body's particular circumstances. There has been a slight trend towards higher fees, to reflect the financial problems that there have been in colleges in Scotland.

Secondly, there is a straightforward timing issue. The financial year runs from April to March, but the colleges' financial year runs from August to July. The amount of work that is completed at the year end varies for a range of reasons, which can affect the amount that is shown in the accounts. We can provide Dr Simpson with more detail on that, if he likes. I have described the broad picture of what is going on.

**Dr Simpson:** That is fine.

**Andrew Welsh (Angus) (SNP):** Audit Scotland's annual report and work programme demonstrate the almost breathtaking range of activities that the agency undertakes. For example, work has been done that relates to fire authorities, migrant workers, the NHS, air quality, and central and local government. The proof of the pudding is clear to everyone in the organisational improvement and efficiencies that have been achieved through Audit Scotland's encouragement of good practice, at a cost that is a fraction of the £29 billion that the audited organisations spend.

I thank the Auditor General and his staff for and congratulate them on their work to promote good governance and value for money throughout Scotland's national and local organisations—I have seen their work in action for eight years.

**The Convener:** I am sure that all members share those sentiments, whether we are rookies on or veterans of the Audit Committee. That is an excellent start for the Auditor General and his staff in this session of Parliament. I daresay it might be downhill all the way from here.

If there are no further comments or questions on the annual report, I ask Ms Gardner to introduce the forward work programme.

**Caroline Gardner:** Members have a copy of our detailed forward work programme, so I will simply pick out forthcoming highlights, which might be useful to the committee as it plans its own work programme for the next few months.

Our work programme was agreed after wide-ranging consultation with a range of public bodies and stakeholders and, of course, the Audit Committee. We have tried to achieve a balance across the public sector while identifying big issues for us all. We have looked ahead to what might come over the horizon—we try to spot issues that will be important in 18 months' time. We have aimed to cover big themes such as environmental sustainability, health and community safety, and cross-Government themes such as major capital projects and the use of consultants. We will also undertake work that contributes to post-legislative scrutiny, for example in the context of mental health services and civil contingency planning.

We did not publish any reports during dissolution—there was a moratorium in the period leading up to the election—so quite a lot of reports are in the pipeline and will be published during the next couple of months. Before the committee's next meeting, we will publish in August reports on people with long-term health conditions, youth offending and out-of-hours services in the health service.

In September, work will come forward on sustainable waste management, how the higher education estate is managed, and the management of emergency and non-emergency calls to the police service. Over the winter period, there will be a major report on the performance and finances of the NHS in Scotland, a look at the school estate, and a review of free personal care, which is due in the winter of 2007-08 and is currently planned for around the turn of the year.

In addition, the committee will receive from time to time what we call section 22 reports, which are an opportunity for the Auditor General to bring to your attention issues that come out of the audits of individual bodies. Two of those are on the agenda today, on further education colleges. There may be more over the next few months, first on the health service and secondly on central Government bodies. It is difficult for us to plan those in advance as they arise when particular issues come out of audit work. They will be reported to the committee on its routine agenda.

I will stop there, but I am happy to answer any questions.

10:15

**The Convener:** Thank you. Are there any questions on the forward work programme?

**Murdo Fraser (Mid Scotland and Fife) (Con):** I have a question of clarification. I see that, as part of the programme, an investigation into major capital projects is planned. I do not want to pre-empt later agenda items but, on the assumption that the Edinburgh transport projects proceed, I presume that they fall under that further inquiry. Is that correct?

**Caroline Gardner:** They certainly would. It became clear to us in the first two sessions of Parliament that the way in which capital projects are examined can often be less structured than our consideration of revenue expenditure. Before the transport issues became live in the past few weeks, we had started a piece of work to examine all major capital projects. Many of those are in the transport sector, but others are not. The aim is to do a first cut that considers them all and then agree how to keep major capital expenditure under review on a continuing basis in the future, given its importance to the Parliament and public services throughout Scotland.

**Murdo Fraser:** Thank you. That is helpful.

**Mary Mulligan (Linlithgow) (Lab):** The programme in front of us is full, and Caroline Gardner has identified the section 22 reports that could arise. How much flexibility does Audit Scotland have if other issues arise that we have not predicted but clearly need to be investigated?

**Caroline Gardner:** Ensuring that we make best use of our resources while being able to respond to new circumstances is always a challenge for us. We manage that challenge by keeping a small contingency so that we are always in a position to respond to big issues as they arise. We also accept that, when that happens, we may have to slip or decide not to do pieces of work that were planned. We hope that those two approaches give us enough flexibility.

**Willie Coffey:** I want to ask some general questions about the forward plan and the audit process that you plan to adopt. Will there be more engagement with the public on its perception of outcomes, impacts and benefits gained from particular work? My understanding is that, in previous years, the focus has largely been on systems and processes, delivery and risk management. The public perception of service delivery is obviously important. Is there a changing emphasis to move in the direction of assessing and reporting back on that?

**Caroline Gardner:** There certainly is. It is fair to say that much of our work has focused on the organisations that deliver public services rather than on the people who are paying for and receiving services, but that balance is shifting. For example, the work on out-of-hours services that is currently being pulled together has a strong element of research with people who have, and have not, used out-of-hours services. That was carried out to get a sense of what matters to them and whether they feel the quality of service met their needs in practice. One of our objectives for this year is to build in that work more systematically. It will not always be appropriate, but very often it will be; when it is, we should be doing it.

**The Convener:** I thank Caroline Gardner. We note the position in relation to both reports.



## Edinburgh Transport Projects Review

10:19

**The Convener:** Agenda item 4 is on Audit Scotland's report, "Edinburgh transport projects review", the specific projects being the Edinburgh trams and the Edinburgh airport rail link. The committee has agreed to discuss in private any recommendations that we wish to make as a result of the report. We will do that later on, but now is the opportunity for Audit Scotland to set the scene and for committee members to ask questions. I welcome Margaret Smith to the committee for this agenda item. Margaret is an Edinburgh MSP whose interest in these transport projects has been clear and consistent; I will give her the opportunity to participate in the questioning once committee members have had their fill.

I invite Robert Black to make some introductory remarks on the report.

**Mr Black:** I am conscious that this is a live issue of great concern to the Parliament. The report has been around for only a short time, so I welcome the opportunity to take a few minutes to share some of its key messages and to set it in context.

The review was carried out in response to a request from the Cabinet Secretary for Finance and Sustainable Growth to look into the arrangements for managing and estimating the costs of the Edinburgh trams project and the Edinburgh airport rail link project. The latter is often referred to as the EARL project; if members do not mind, I will call it that from now on.

As Caroline Gardner said, I decided earlier this year that Audit Scotland would undertake a review of major capital projects in Scotland in its forward work programme. This report therefore brings forward work that would have been undertaken anyway over a longer timescale. I thought that it was in the public interest and the Parliament's interest that I should make the objective audit evidence available to Parliament on a timescale that fits with the decision-making procedures.

The review looks both at the process for estimating project costs and at the project management arrangements for the trams and EARL, but I must also say what the review does not do. It does not provide assurances on the accuracy of the estimated costs—in other words, we did not reperform any analysis; it does not look at the operating costs or the projected revenues of the projects, both of which factors could have a significant impact on the financial operation of both projects; and it does not go back to review the option appraisal procedures for the projects, or the

benefits that they were expected to generate, which are, in essence, a policy matter.

The same organisations are involved in both projects, although the roles that they play have been different in each of the projects. The report describes those organisations and roles more fully; I will outline them briefly. Transport Scotland is the executive agency and principal funder of both projects on behalf of the Scottish Executive. For the Edinburgh trams, the City of Edinburgh Council is the promoter and part-funder; but for the EARL project, the council's role is that of planning authority. The third key player is Transport Initiatives Edinburgh Ltd, commonly known as TIE, which is a not-for-profit, private limited company that is wholly owned by the council. Its task is to deliver major transport projects for the council. TIE has managed the Edinburgh trams project throughout—from obtaining parliamentary approval to designing the tram system and appointing contractors to deliver it. The Scottish Executive later appointed TIE as the promoter of the EARL project—in 2003—but its role in relation to EARL is more limited.

We found that each of the key players had satisfactory high-level governance arrangements in place in order to oversee the projects. Those arrangements are described in paragraphs 27 to 38 of the report, but I will outline them briefly. Transport Scotland has a monthly board meeting to review progress. The board is supported by a major investment decision-making board, which meets monthly to consider major project proposals. In turn, that board is backed up by Transport Scotland's rail delivery directorate, which reviews its own programme of major projects and commissions gateway reviews in accordance with best practice and Treasury guidance.

TIE's board meets regularly to review corporate strategy and to oversee project delivery and financial performance. TIE operates financial management through a scheme of delegated authority. It submits requests for funding to Transport Scotland—directly when the funding is for EARL, or via the council when the funding is for the trams project.

One point that I want to mention specifically is that TIE has changed its board membership. Changes are also taking place in its executive team. Those changes are intended to ensure that the right skills and experience are in place for different stages of project development. However, there will be a need for stability in the management team as either or both of the projects move into critical stages of their implementation. The TIE board is well aware of that.

I will speak briefly about each of the projects, taking the trams project first. TIE originally

identified three possible tram lines and the Scottish Executive announced its support for two of them: a northern loop to connect Granton and Leith to the city centre, and a western line to connect the city centre to Edinburgh airport. It was later decided that the project should be carried out in stages, with phase 1—which is the subject of the report that we are discussing—comprising two parts. Phase 1a will connect Leith waterfront to Edinburgh airport via Princes Street and Haymarket, and phase 1b will link Granton round the north loop back to Roseburn. Both phases are expected to generate more benefits than they cost—I describe the benefits briefly in the report—but members will note that phase 1b is expected to provide higher benefits, because it is expected to contribute to the regeneration of Granton.

The substantial costs that are involved in the project are clearly a concern to Parliament. I will remind the committee of the situation, as we understand it. The original estimated cost for the project in January 2004, including the phases that are not now being developed, was £473.5 million at March 2003 prices. In other words, the overall cost at that time took no account of inflation or of assumptions about how the project might be developed or the profile of the spending over time. By January 2006, TIE estimated the cost of both parts of phase 1 as £435 million at March 2003 prices and £570 million at projected outturn prices. That latter figure included £135 million to take account of inflation and assumed spending profiles. The current anticipated final cost of phase 1a is £501.8 million at projected outturn prices. For phase 1b, the current anticipated cost is £92 million at projected outturn prices. The increase in cost between January 2006 and now is largely a result of the development of the design of the project.

As I am sure the committee is aware, the Scottish Executive has committed to providing up to £500 million for phase 1a and the City of Edinburgh Council will contribute a further £45 million, although that is for phase 1 as a whole. There is therefore enough funding in place to proceed with phase 1a, but a shortfall of about £49 million must be made up to allow phase 1b to commence. Transport Scotland has not confirmed funding for phase 1b, because it expects that every effort should be made to generate savings from phase 1a and it expects to maximise contributions from the private sector developers that will benefit, particularly from phase 1b.

We consider that the project estimates have been subject to robust testing. TIE has subjected them to independent review by consultants and it has benchmarked the estimates for infrastructure construction—where a lot of the outstanding risk still lies—against a recently completed tram system elsewhere. It is important to realise that for

the trams project, initial bids for infrastructure construction were received in January this year, which means that 79 per cent of the project estimate is now based on rates and prices from firm bids that have been received, or on known rates that have been applied to the estimated quantities, for example, the utilities diversion work. A further 20 per cent is based on applying market rates to quantities that have been derived from preliminary designs. That gives TIE a high degree of confidence that it can deliver phase 1a to the current anticipated final cost of just less than £502 million. As I said, we did not reperform the cost analysis; we examined the systems of control in relation to the project.

Some slippage in the project has occurred, but action has been taken to ensure that phase 1a can be operational by early 2011. TIE has brought forward some critical works, such as the construction of the tram depot at Gogar, and it now expects phase 1a to be operational in January 2011.

The arrangements to manage the Edinburgh trams project on a day-to-day basis appear to us to be sound; I describe them in some detail in paragraphs 56 through 65 of the report. There is a clear corporate governance structure, which includes a trams project board. Project management and organisation are clearly defined—there is a clear project programme with documented procedures for change control. Procedures are in place to manage the risks associated with the project. As we might expect with such projects, the allowance for risk and contingencies has reduced as the project has advanced and it now comprises 10 per cent of the current project cost estimate. Finally, the procurement strategy, which I describe in paragraph 64, has been designed to minimise risk.

10:30

As I mentioned, the risks with the highest costs relate to the diversion of utilities. There are also risks of general delays. I am not saying that this is likely to happen, but if, for example, the traffic regulation orders were not in place in time, that would add to the cost.

It is clear that the trams project is approaching a critical phase leading up to early 2008, when cabinet secretaries and the council are expected to be asked to approve TIE's final business case, which will allow the infrastructure construction to commence. A range of key tasks need to be completed before the final business case can be signed off and, unless the work progresses according to plan, the cost and time targets might not be met.

I turn to the airport link project, which the committee will be pleased to hear I will not spend quite so long on. An important point to note is that the airport link project is not as far advanced as the trams project. In March 2006, the estimated cost was between £550 million and £650 million. The latest underlying cost estimate is £633 million, which is about 4 per cent higher than the previous estimate. We think that there has been a thorough estimating process at the strategic level, but although reviews have been conducted by consultants and by Network Rail, there is much less certainty about the figure of £633 million because the EARL project is at a much earlier stage than the trams project. So far, no significant construction contracts for EARL have been awarded, so TIE's cost estimate is based on figures that have not been tested in the market.

A further important consideration is that the funding arrangements have still to be settled. The previous Scottish Executive committed in principle to fund the capital costs of EARL. There are three funding options, which I describe in the report. The first and most obvious option is that Transport Scotland could fund the project through grants, but it would have to balance any commitment to EARL against the funding requirements of other major projects in Scotland.

Secondly, there is a source of funding known as regulatory asset base—or RAB—funding, which is a special form of finance that is available to Network Rail. It allows Network Rail to borrow to fund investment, but on the basis that Transport Scotland would need to fund the subsequent increase in Network Rail's charges. RAB funding would help Transport Scotland to fund more projects in the short run, although there is a limit to the amount of borrowing that can be made against the RAB and Network Rail would need to balance the use of RAB funding for the airport project against its use to meet other investment needs.

A third possible source of funding is the European Community's trans-European network fund, through which a grant might be available for certain procurement options. However, it is by no means clear whether or to what extent that source could be drawn on for the airport project.

In addition to those sources of funding, Transport Scotland has negotiated with BAA, which owns Edinburgh airport, in an attempt to secure a financial contribution to EARL. Although BAA has not committed to any direct financial contribution, it has agreed to meet the costs of providing a passenger interchange, at an estimated cost of some £3 million. In addition, Transport Scotland has provided an indemnity on behalf of the Scottish Executive to meet any additional costs or damages suffered by BAA as a result of the EARL project.

We consider that the day-to-day arrangements to manage the project appear to be generally sound. As with the trams project, there is regular financial reporting and procedures are in place to manage the associated risks. However, two key factors are inhibiting progress with the project, which, taken together, mean that we consider that EARL is unlikely to be delivered by the target date of the end of 2011.

First, there is not yet a clear governance framework to ensure that all parties' interests are co-ordinated at the top level. An EARL project board was established in 2005 and it includes TIE, Transport Scotland, Network Rail and BAA. However, it did not meet between April 2006 and February 2007 and it has met only twice since then. Its membership is not agreed between the main stakeholders and there is no date for the next meeting. As I said earlier, Transport Scotland has been unable to persuade BAA to make a financial contribution to the project of the order that was originally expected, and the roles of BAA and Network Rail as delivery partners have not been agreed.

The second factor that is affecting progress is that the procurement strategy has not yet been agreed. A number of key decisions need to be made before there can be more certainty about the cost and time targets. For example, the reference design is a major stage in developing the design of the project, but it is not yet complete, and the form of the contract is undecided. Accordingly, the cost estimates are still to be tested in the market. All those factors mean that there is much more uncertainty about the EARL project than might be expected, given the length of time for which it has been in development.

I trust that the report provides objective information that will help with the important decisions that will be made soon on the two projects. However, I emphasise—if I may mix my metaphors—that we are giving snapshots at a point in time without having the benefit of a crystal ball to help us. No major capital project is without risk, however good the project management is. It is necessary to have a good system in place, but that does not guarantee that future risks will not materialise. I cannot give you an assurance on what the future might hold for either project.

With the assistance of colleagues who know much more than I do about the detail, I will be happy to answer any questions.

**The Convener:** Thank you, Mr Black.

Colleagues, we will put questions on the trams project first and then move on to EARL. That will make for tidier proceedings.

**Jim Hume (South of Scotland) (LD):** In your view, Auditor General, was the trams project at any time financially out of control?

**Mr Black:** We reviewed only the current project arrangements. There is a degree of assurance in the fact that the movement between the first cost estimates and the current ones can be clearly explained—it relates to changes in the project design and the impact of inflation. Given the time that was available, however, we did not consider the history of the project in detail.

**Jim Hume:** But what you considered showed that nothing was financially out of control.

**Mr Black:** As we find the project at the moment, the management and control systems are sound.

**Murdo Fraser:** We should never entirely trust our friends in the media, but they characterised your report as giving trams

“a clean bill of health”.

Is that a fair description of your findings?

**Mr Black:** I can offer the committee and the Parliament a positive assurance about the strength of the management systems and control systems that are in place for the trams project. Because the Edinburgh airport rail link is at a comparatively early stage of development, the same assurance cannot be offered. There are significant issues in the lack of clarity about the roles that key players such as Network Rail, BAA and others will play in the EARL project.

**Murdo Fraser:** So you are relatively satisfied with the trams project as it stands.

**Mr Black:** We are relatively satisfied with the controls that are in place.

**Mary Mulligan:** The utilities part of the trams project has been put on hold. If there should be further delays, what are the risks to the overall project?

**Mr Black:** There are two main categories of risk. The first is that costs will continue to increase. We have not audited this number, but Transport Scotland advises me that the project currently costs the public purse about £4 million every month. It is possible that that cost will ramp up over the summer if the project is delayed. The second significant area of risk is that several tenders have been received for critical works and the project sponsor and project manager are concerned that some tenderers might lose interest and want to compete for other work elsewhere. That could cause a significant setback. In my opinion, those risks are real.

**The Convener:** You said that approval of the final business case for trams is due in early 2008.

Did you say that the cabinet secretary would give final approval?

**Mr Black:** The business plan would be submitted to the twin sponsor bodies, the local authority and Transport Scotland, which would scrutinise it carefully—particularly Transport Scotland, because it is concerned with Parliament’s interests. Final approval would then be afforded by the cabinet secretaries.

**The Convener:** How much is likely to be spent on the trams project between now and then? Is that what the figure of £4 million per month relates to?

**Mr Black:** That is a broad, indicative figure of how much money is being spent every month. Any further questions will probably have to be addressed to Transport Scotland.

**The Convener:** It is inevitable that before final business case approval there will be some expenditure takes up-front that, in a cancellation scenario, are rendered abortive. Is that just in the nature of the beast?

**Mr Black:** You are absolutely right, convener. Transport Scotland has given a broad indication of the possible cancellation costs, and I think that I am correct in saying that it would cost between £27 million and £35 million to cancel the project sometime in the near future.

**The Convener:** But it might be a larger sum than that if the final business case is not approved in 2008.

**Graeme Greenhill (Audit Scotland):** The £4 million per month is being spent on things like staff salaries and the construction of the depot at Gogar. That expenditure will go on. The £27 million to £35 million to which the Auditor General refers relates to things like penalty clauses for cancelling contracts and redundancy costs, for example. If this expenditure continues between now and January and the project is cancelled in January, that £4 million per month will be lost and the £27 million to £35 million will have to be paid on top of that.

**Andrew Welsh:** There will be doubts about continuation and cancellation. Everyone is looking for clarity and certainty about the organisation and finance of both projects. Paragraph 4 on page 2 of the review shows the process by which the costs of both schemes have been estimated and managed, but not their accuracy or certainty. The review is not an evaluation of either project but is a review of the process by which costs have been estimated and how the project management has been arranged. Is it therefore true to say that the review provides greater clarity about the process, but that there is no certainty about the cost estimates?

10:45

**Mr Black:** It is certainly true that the report provides a clear assurance in relation to the processes that the trams project is going through. It is also true, however, that the cost estimates have been robustly prepared by project management. However, in any capital project of this scale and complexity there is no such thing as absolute certainty about what the outturn costs might eventually be.

**Andrew Welsh:** Is it not also true that we cannot at this point be sure of the accuracy of the estimated project costs, the projected revenues or options appraisals or the benefits that are offered by the two projects?

**Mr Black:** As I said a moment ago, you can take assurance that the project costs have been robustly calculated to a standard commensurate with that of other major public programmes. We certainly have not looked at the numbers again; as I said, we have not reperformed any of the analysis. As I think that I might have mentioned in my introduction to the report, we have not looked at how the benefits are calculated.

**Andrew Welsh:** It is unlikely that EARL will be delivered by 2011. There is no agreement over procurement strategy, no clear governance framework and so on. Surely all those doubts and uncertainties would have cost effects.

**The Convener:** Andrew, can we dispose of the questioning on the tram before turning to EARL?

**Andrew Welsh:** Sure. My general point, however, was about the doubts—

**The Convener:** I appreciate that you were making a general point.

**Willie Coffey:** My question for Mr Black is related to Andrew Welsh's. Was the fact that you did not consider the accuracy of specific costings due to the scope of the audit that you were asked to carry out, or is that simply something that is difficult or impossible to predict?

**Mr Black:** I should be very clear about this. The scope of the audit work was determined by me. Some of the media appeared not to appreciate fully the relationship that I have to Parliament and the Executive. Normally, in reviewing projects such as this, we examine the systems and procedures that are in place. However, we are not qualified to take over the role of management; it is not appropriate for us to do that and we do not have the required expertise in house. We would not, as a matter of course, reperform expert calculations; we would leave that to others.

**Willie Coffey:** So the element that is of major interest to the public—the financial aspects of the

project and its delivery—was outwith the scope of your examination.

**Mr Black:** Yes.

**Dr Simpson:** Considerable play has been made in Parliament about the massive increase in the cost of the Stirling-Alloa-Kincardine railway. However, your report suggests that that sort of cost escalation has not occurred in the case of the trams project.

Do we have a figure for the upper end of the estimates of the cancellation costs—the money that would be spent even if the project were cancelled today? I have the figure for the current expenditure and Transport Scotland's estimate, which suggests that the likely cost would be between £27 million and £35 million. I know that £62 million has been spent to the end of May 2007 but, if the project is cancelled, there will be a winding-down period during which people will be made redundant and other costs will accrue. Do we have a global figure for the cancellation costs? Is the figure of £4 million a month the only additional cost that is likely to rack up if the decision is delayed until after the recess?

**Mr Black:** It is true to say that the broad estimate of cancellation costs that we have been able to obtain is in the range that I mentioned earlier, which is £27 million to £35 million. That cost will be incurred if there is cancellation in the near future.

Obviously, we have not projected forward what other costs might be involved, for reasons that Graeme Greenhill described earlier. The further the work proceeds, the more money is committed and the more likely it becomes that cancellation costs will be higher.

I have read and heard that some people are concerned that the financial performance of the Stirling-Alloa-Kincardine rail link might be a precedent for the financial performance of the trams project. We have not yet looked at the Alloa rail link; we will do so as part of the major review that we mentioned earlier. However, I point out that Clackmannanshire Council was the original project sponsor and manager of the link between Stirling and Alloa; TIE was brought in at a much later date. There have been a number of problems with the management of the project, and Transport Scotland has commissioned a number of reviews to see what lessons can be learned from it. It is significant to note that TIE took over management of the project part way through. That is quite different from the Edinburgh trams project, in which TIE has been involved right from the start.

**Dr Simpson:** Those comments were helpful. Paragraph 48 of the report states that

"£17 million was spent taking the two tram Bills through the Parliamentary process"

and that a further £62 million was spent

"up to the end of May 2007".

Estimated cancellation costs at the upper end are £33 million. According to my reckoning, that means that there will be costs of about £115 million, even if the project is cancelled today. Those costs will rise by £4 million for every month that the project is delayed.

**Mr Black:** It is correct to say that that order of money would have to be written off.

**Dr Simpson:** That is helpful.

**Stuart McMillan (West of Scotland) (SNP):** As a new member representing the West of Scotland region, I was far removed from the transport plans for Edinburgh. The report answers some of my questions.

For me, the most important paragraph in the report is paragraph 4, to which you alluded earlier. In that paragraph, you state that the review examined the estimated costs of the projects, and you make it clear that

"It does not provide assurances on the accuracy of the estimated project costs."

That is the important aspect of the transport plans. If more than £1 billion of public money is to be spent on a capital infrastructure scheme, that spending must be subject to the utmost scrutiny, to ensure that every pound and penny are spent correctly.

In paragraph 52, you mention value engineering savings and you said earlier that project costs have been robustly calculated. Are you saying that phase 1a of the trams project will come in under budget only if the value engineering savings to which you refer take place?

**Mr Black:** No. The current cost estimates fall within the indicative budget that has been provided. Value engineering is a well-established range of techniques that are designed to bring costs down from initial bid figures to the minimum that is absolutely necessary to deliver the project. We understand from Transport Scotland and TIE that the process is going reasonably well at the moment. Transport Scotland is incentivising the process, to ensure that phase 1a is delivered for the minimum cost. It hopes that that will free up resources that will allow phase 1b to be funded.

**Stuart McMillan:** I do not know whether you can answer this, but why is BAA not a key stakeholder in the trams project? It is a key stakeholder in EARL.

**Mr Black:** I am not sure that I can answer that. It is clear that BAA has an interest, but the trams project is entirely separate from the EARL project.

**Graeme Greenhill:** We do not have a clear answer to that question.

**Stuart McMillan:** There appear to have been four changes to TIE's board membership during the past 12 months, which seems excessive. I would hope—and expect—that any major project would benefit from an element of consistency. Did you consider that?

**Mr Black:** I understand that there might be concern about turnover, which is why I mentioned it in my introductory remarks. However, Transport Scotland and TIE acknowledge that, as a major construction project such as the trams project progresses, the skills that are required at board and non-executive level, in order to hold the project management to account, and the skills that are required in the project management, change. We have been given a reasonable assurance that the process is being managed well and that strong project management is in place as we speak.

Instability in the project management team would be a risk as the project progresses. There is nothing unique about the trams project in that regard: in any major capital project that runs for an extended period there is a risk if key members of the project team are not in place throughout the project's duration.

**Stuart McMillan:** I accept that point, but I still think that four changes in 12 months is excessive.

**Jim Hume:** First, are remarks such as those in paragraph 4 fairly standard in an Audit Scotland report? Secondly, the Auditor General said that the financial benefit to Scotland would be greater than the cost of the project. What is the estimated financial benefit to Scotland?

**Mr Black:** Paragraph 4 is not untypical of what we put in reports, but—I am sure the committee appreciates this—it is a particularly important paragraph in this report because we have had an unusually short time to undertake the audit examination.

The overall benefit-cost ratio for the trams project is £1.63 per £1 of cost for the whole of phase 1. The phase 1a BCR is £1.10 per £1 of cost. The phase 1a figure is lower because phase 1b is expected to generate higher benefits, because it is expected to contribute to the regeneration of Granton through job and infrastructure creation. That is a broad indication of the position. As I said, we have not reperformed the BCR analysis. We do not have the skills to do that; it is a highly complex and specialised area. I have given you the numbers that we were given.

**Jim Hume:** I presume that something that makes the costs rise will also make the benefits rise, because both will be inflationary.

**Mr Black:** It is important to take the numbers as being broadly indicative and no more. I am not expert in this area, but I know that it is a highly complex and specialised business. All tram projects around the country will have been subject to similar analyses, but the assumptions will vary according to the latest Treasury guidance and local circumstances.

11:00

**The Convener:** I remind colleagues that we should be asking factual questions about the tram project at this stage. When we have finished that, we will go on to factual questions about the EARL project. Later, in private session, we will have the opportunity to debate among ourselves how we move forward to any recommendations.

**Mary Mulligan:** I want to be clear on one point, Mr Black. "Doubt" may be too strong a word, but there is perhaps some concern in respect of your remit for the report. My understanding was that you were considering whether the processes and procedures were in place to allow the project board to make reasonable estimates. The report says—to paraphrase paragraphs 14 and 15—that arrangements to manage the project appear to be sound, but there is recognition that the project is approaching a critical phase. Is not that what you were looking at, rather than comparing estimates?

**Mr Black:** Yes, that is correct.

**Mary Mulligan:** Thank you.

**The Convener:** I will call Margaret Smith in a minute. She has been very patient, but I want to raise a couple of points of my own.

Mr Black, you resisted the temptation earlier to use the phrase "clean bill of health". I suspect that it is one that you would avoid at all costs. I do not think that you would use the phrase "quick and dirty" about the reports, but you had only three weeks to produce reports that are essentially about processes. You have told us that the processes for the trams are fairly robust, but are less so for EARL, on which you have highlighted governance and procurement processes as being unsatisfactory.

I would like to get a feel for the available information and the accuracy of hard figures. You mentioned that there were some tenders in relation to the trams. I presume that market forces can give an indication of some aspects of the tram costs. Will you expand on the robustness of at least some of the figures that are available at this stage for the trams project's life?

**Mr Black:** You are correct to assume that I would not be terribly keen to describe the report as "quick and dirty". It is an objective reality that it has been quick, but the important point is that I can offer the assurance to the committee that we have examined the procedures pretty thoroughly.

As I said of our work programme, we had the opportunity to consider the project in a general way when we were preparing the major transport review last autumn. As said in describing the annual report, there is an appointed auditor for Transport Scotland, and there is also the auditor of the City of Edinburgh Council. We can use knowledge and understanding of what is going on, particularly from the audit of Transport Scotland, to get a good feel for the systems. We had already started planning for the capital project work next year, so we had a good general understanding from which we could develop the work.

On your more specific question about the project estimates, TIE subjected the figures to independent review by consultants. As I think I mentioned in my introduction, it has benchmarked the costs, including infrastructure costs, against other UK tram projects. That provides a degree of assurance. Confidence in the cost estimates is considerably greater now than it was even a few months ago, because bids for infrastructure construction, where a lot of the risk lies, were received in January 2007. Just short of 80 per cent of the project estimate is based on rates and prices from those firm bids—that is an important point to bear in mind—or is based on known rates being applied to estimated quantities. So, getting on for four fifths of the cost is on that basis. A further 20 per cent is based on applying market rates to quantities that are derived from the preliminary designs. TIE is well through that cost process. Our understanding is that about 10 per cent of the overall cost is still there for risk and contingencies. The element of risk allowance has reduced as TIE has received bids with costs attached. Does that help?

**The Convener:** Yes—thank you.

Margaret Smith has been very patient. Now is her opportunity.

**Margaret Smith (Edinburgh West) (LD):** Thank you, convener, for letting me speak at all. As an outgoing member of the committee, I wish colleagues who were on the Audit Committee with me in the previous session of Parliament, and the new members, all the best in their time on the committee—it is certainly an interesting one to be on.

We have heard that one impact of the delay in the tram scheme is an extra cost of £4 million a month. At paragraph 67, the Auditor General makes the point that a loss of key members of

staff is possible. We should consider that in excess of 100 similar schemes are in process throughout the world. How much of a problem would a loss of staff be for the viability of the project if we have on-going delay?

**Mr Black:** The report identifies the loss of staff as a risk. Unfortunately, I cannot comment on how great the risk is. Transport Scotland is best placed to answer that question.

**Margaret Smith:** I will ask my governance question now, if I may. I share the concern of some colleagues about whether the relatively short time that you had to produce the report was adequate for your and our needs. I am reassured by what you have said, but I have a question on a more general governance issue that relates to Audit Scotland's approach to such projects. You will probably not be surprised to know that my question relates to the several questions that I asked you in the previous session's Audit Committee on 13 February about the potential for real-time monitoring of such capital projects. In your response, you expressed concerns about such a role for Audit Scotland, which related to resourcing and accountabilities. On about three or four occasions, you made it clear that you envisaged a role for Parliament if Audit Scotland was to carry out such monitoring. What dialogue did you enter with Parliament when you received the request from the Executive to undertake a very important—some would say controversial—short-term project?

**Mr Black:** I have had no direct dialogue with Parliament on that.

**Margaret Smith:** That lack of dialogue is absolutely different from the approach that you suggested you would take in response to my questioning on 13 February. Was your decision not to have a dialogue with Parliament—in direct contradiction to the approach that you set out—a result of the timing of the request and the lack of an Audit Committee? I believe that we had a Presiding Officer, who could be thought of as a representative of Parliament. Was there some other reason that led you to decide that you did not need to have a discussion?

In February, you said:

"I am concerned about ensuring that Audit Scotland adds as much value to the process as it can, and there should therefore be dialogue on the matter with the Executive and the Parliament".—[*Official Report, Audit Committee*, 13 February 2007; c 2027.]

Why did you think that there was no value in dialogue with Parliament—to which you give your reports—or in intimating that you were undertaking the short-term report? Why has the dialogue ended up being between Audit Scotland and the Executive, when Parliament is the crucial third

partner? Clearly Parliament is not the Executive and the Executive is not Parliament.

**Mr Black:** The answer to that is comparatively straightforward and was, I think, implied in the question. This committee and the other committees of the Parliament were not formed at the time. You are right to say that it is a most unusual circumstance that I should be asked whether I could produce a piece of work in order to inform some important decisions that were being taken. The work had been planned earlier—the new timescale was undoubtedly tight, but it was in the public interest for us to do the work.

Had we not been close to the election, in a period during which this committee was not constituted, I would normally have consulted first and foremost the convener of this committee, to take soundings. However, that was not possible until the committee was constituted.

I want to remind you of one very basic issue: I am reporting to Parliament; I am not reporting to the Executive, to a minister or to a civil servant. I am reporting to Parliament and I am very prepared to be held to account for the quality of the analysis and findings in this report.

**Margaret Smith:** I do not have an issue with the fact that you are reporting to Parliament now; what I have an issue with is that, when I asked you the question on numerous previous occasions in the then Audit Committee, you said that if you were ever in such a situation again, there would be dialogue with Parliament. On this occasion, Parliament was in session. The Audit Committee may not have been constituted, but Parliament was in session. I am interested to know whether there was any dialogue—letters or an intimation to the Presiding Officer or to Parliament itself—to suggest that the work was being undertaken. From what you have said, I have my answer.

**The Convener:** I do not think that we want to labour the point, but I will give Mr Black the chance to respond once more.

**Mr Black:** I have nothing to add, other than to say that I hope that the committee generally agrees that it has been in the public interest to have the analysis and information available to Parliament before key decisions were made. The alternative would have been for me to do nothing until the Audit Committee was properly constituted, in which case the analysis in the report would not have been available to you.

**Margaret Smith:** Another option would have been to write to the Presiding Officer, but I will say nothing more.

**The Convener:** Margaret, do you want to ask any other questions about the trams project—



preferably questions that the rest of us fully understand?

**Margaret Smith:** No, that is enough.

**The Convener:** I can see that there is a history behind this.

If colleagues have finished asking questions on the trams part of the Auditor General's report, I invite them to ask questions about the EARL project. Have we punched ourselves out? No, we have not.

**Mary Mulligan:** Mr Black, in your report, you express clear concerns about the governance arrangements and the procurement strategy for EARL. In paragraph 85, you talk about the establishment of the EARL project board and about its record of meetings, which you also referred to in your opening comments. Who established the EARL project board? Who brings the partners together? Why did the regularity of meetings break down? There seems to be a 10-month period during which the board did not meet, and since February 2007 it has met only twice. What has been the problem with relationships on the board? The board is clearly critical to driving the project forwards.

11:15

**Mr Black:** Transport Scotland is the project sponsor for EARL and it has commissioned TIE to help it to progress the project. In other words, TIE's role is much more limited than it is in relation to the trams project. Transport Scotland and TIE were the key players in bringing together the original board. As we describe in paragraph 85, the board has not had many meetings—it did not meet between April 2006 and February 2007, and it has met only twice since then. That is a matter of fact. I am not able to help you with the reasons for that; Transport Scotland would be in a better position to explain.

It is probably fair to offer the general thought that, given that the project represents a significant commitment in Scotland for Network Rail and BAA, their wish to take time to consider the matter is understandable. I understand that BAA has been constructive in its discussions with Transport Scotland and TIE. As I think I mentioned in my introductory remarks, BAA has committed funds to provide the link into the terminal, but the discussions have not gone much beyond that, although Transport Scotland has put in place an indemnity in favour of BAA to cover it against the risk of the operation of the airport being affected by the development of the airport link.

**Mary Mulligan:** When you compiled your report, did you speak to all the partners?

**Mr Black:** Personally, I did not. The team's main contact has been with the project sponsor, Transport Scotland, and with TIE. I invite Angela Cullen to tell the committee about the contacts that we have had with the other bodies, which have been fairly limited.

**Angela Cullen (Audit Scotland):** As the Auditor General said, we have spoken to Transport Scotland and TIE and have had limited discussions with Network Rail and BAA, just to clear the facts in the report and to ensure that what we were saying about them was accurate. We did not engage with Network Rail and BAA throughout the process to gather the facts; we gathered the facts from Transport Scotland and TIE and then cleared them with Network Rail and BAA.

**Mary Mulligan:** So Network Rail and BAA did not take the opportunity to raise any concerns about the lack of meetings. Surely people in that position must have recognised that no progress was being made and that something needed to be done.

**Angela Cullen:** They did not. We did not ask them about that. When we asked Transport Scotland and TIE about the position, they clarified that the role and remit of the project board had not been agreed by all the partners and that Network Rail and BAA were not full members of the board but were on it merely in the capacity of observers.

**Mr Black:** It might also be worth noting that we mention TIE's attempts to advance the process in paragraph 87, in which we say:

"TIE proposed a revised governance structure based on a project board, which it would chair."

That structure has not yet been agreed, so it is unfinished business.

**Mary Mulligan:** Do you have any information on whether that will go ahead?

**Mr Black:** No.

**Mary Mulligan:** I have a final, brief question. As the lead body, Transport Scotland needs to make progress. In your discussions with the organisation, did you get any indication that it recognised the urgency of the situation and wanted to do something about it?

**Mr Black:** We can give you an assurance that Transport Scotland has been very active in trying to move the process forward. There is no doubt about that. The same can be said of TIE. We reflect that in paragraph 87. They have been trying to work to an agreed framework, but so far that has not been achieved.

**Mary Mulligan:** Why has it not been achieved?

**Mr Black:** I am sorry, but we do not have the answer to that.

**The Convener:** Would it be correct to say that, instead of thrashing out the remit at board meetings, the partners have circulated draft remits to each other in correspondence?

**Mr Black:** I am not sure that I can help you with an answer to that.

**Angela Cullen:** The role and remit of the board and the partners were discussed at an earlier stage, but they could not be agreed on, which is why the board went into abeyance.

**Murdo Fraser:** Paragraphs 84 to 91 of the report seem to be making serious criticisms of the governance process and the lack of a clear procurement strategy. I am new to the committee and do not have a great deal of experience of reading reports such as this. Could you indulge me with an idiot's guide to the degree of seriousness with which you view the failures in this project? In your experience of dealing with public sector projects of this scale, are the failures in this project very serious, serious or quite serious? How would you pitch this project and the failures that you have identified in comparison with other projects?

**Mr Black:** One of the fundamental differences between the trams project and EARL is that the trams project was primarily a sub-regional project centred on Edinburgh, so there was a clear role for the City of Edinburgh Council, supported by the Executive, to sponsor the project and, in effect, champion it. The council created TIE, with support from the Executive, to make the project happen, and that was all put in place appropriately.

The EARL project is different because it is seen as part of the economic well-being of Scotland. The project is designed to assist the development of Edinburgh airport, which is a significant hub in Scotland and is linked to the future economic development of our country. That means that the stakeholders and key players are different. Although it is right to expect Transport Scotland, as the strategic agency, to drive the project, it clearly relies on the co-operation and full participation of the other key stakeholders: Network Rail, which is responsible for rail infrastructure, and BAA, which owns the airport. Unless and until those agencies are fully signed up to the project, there must be a real chance that its further development will be inhibited.

I urge members not to take the comments in paragraphs 84 to 91 as a criticism of Transport Scotland or TIE. From what we understand about recent developments, Transport Scotland and TIE have been actively pursuing conversations with the other parties but, for whatever reason, it has not yet been possible to clarify an overall project

management structure. It has also not been possible to secure the level of funding—from BAA, for example—that Transport Scotland hoped for.

At this point, I must say that we are up against the limits of an audit analysis of a project that is moving forward in real time. I am not sure that I can say much more than that at this stage.

**Murdo Fraser:** That is very helpful. To clarify, you said that Network Rail and BAA were not fully signed up to the project.

**Mr Black:** I think that it is fair to say that at this stage. By that, I mean that they have not committed funding or agreed the specific role that each party will play in the project.

**Murdo Fraser:** Is it therefore fair to say that, in your view, and from the point of view of public finances, it would be unsafe to proceed further with the project without resolution of the issues that your report identifies?

**Mr Black:** That is a matter for the cabinet secretaries and Parliament to determine, but I hope that the analysis that is presented in the report will inform that judgment.

**Murdo Fraser:** Are the issues that you have identified resolvable? If so, what is a realistic timescale for their resolution?

**Mr Black:** I am sorry, but I would be speculating on the basis of inadequate knowledge about the extent to which the issues can be readily resolved and how long that might take.

**Murdo Fraser:** So might they be irresolvable?

**Mr Black:** I have no view on that one way or another.

**The Convener:** Good try, Murdo.

**Jim Hume:** Earlier, you spoke about an immediate wind-up cost for the trams of between £27 million and £35 million and a cost of £4 million for every month that the project is delayed. What would the figures be for the EARL project?

**Mr Black:** The figures would be much lower because no contracts have been let. That is a significant difference. Perhaps one of my colleagues has some indicative numbers at this stage.

**Angela Cullen:** We do not have any numbers at this stage. As the Auditor General said, no contracts have been let, so there are no penalty clauses. Further, fewer staff are working on this project, which means that redundancy costs will be lower than they would be in relation to the trams project.

**Stuart McMillan:** Paragraph 70 of the report says:

"An economic appraisal of the project in December 2005 demonstrated benefits of £1.63 per £1 cost over 30 years and £2.16 after 60 years."

If that is the case, surely BAA and Network Rail would see the benefits of the project. However, BAA has put in only £3 million. Do you agree that, if the financial benefits were likely to be of the order that is suggested in paragraph 70, BAA would wish to put in more money and become a stronger partner in the project?

**Mr Black:** As you might imagine, my answer is that that is a question that is best put to BAA, possibly through Transport Scotland.

I will explain the general context of the figures that are presented in paragraph 70. The basic objective of EARL is to assist the development of Edinburgh airport and help it to cope with growth in passenger numbers. My understanding is that the calculations are based on the projected growth in passenger numbers from 8 million in 2004 to 12 million in 2015 and just over 20 million in 2030. That projection is critical to the calculation of the benefits of the project.

As I remarked earlier in relation to the tram project, benefit-cost calculations are extremely complex. The calculation concerns not only what counts as a benefit and how that is calculated but to whom the benefit accrues. In a project such as EARL, much of the benefit relates to people travelling by rail instead of car or taxi. It is for BAA to decide whether that is a significant benefit to it as the operator of the airport.

**Stuart McMillan:** Certainly, some of the benefits will go to the public. They will also go to the likes of BAA and airlines. Have any airlines been contacted with a view to getting them to contribute to EARL or the trams project?

**Mr Black:** We have no knowledge of that. We would not have that information. Certainly, we have not made any contact.

11:30

**Dr Simpson:** In paragraph 43, you analyse nicely the benefits of the tram project in terms of jobs, homes, factory space and so on, all of which relate to the city. However, the economic appraisal of the project's benefits is not spelled out in your report. Can you give us figures on that, or is there a consultant's report that spells out the benefits in a great deal more detail, which we could get hold of very quickly?

You mentioned passenger numbers. If we could save a majority of the anticipated 12 million additional car journeys to the airport that will be being made by 2030, we would make a significant contribution to overall strategy in Scotland on, for example, CO<sub>2</sub> emissions. The creation of a new

transport hub would benefit not just Edinburgh but areas such as my region, Mid Scotland and Fife, which benefits substantially from connections with Edinburgh. The alternative would be for people to continue to travel into the already overcrowded Waverley station. I would like to see a more detailed analysis of such benefits, if it is possible to get hold of one quickly, because the issue is fundamental to whether the project should go ahead.

**Mr Black:** The numbers in the economic appraisal are given in paragraph 70, and a footnote gives the source as the "Design Development Appraisal Final Report" on the airport link, which was produced by the consultant Scott Wilson Halcrow in December 2005.

**Dr Simpson:** We should be able to get hold of the Scott Wilson Halcrow report; it is a public document. Will it contain the analysis that I am asking about?

**Mr Black:** Yes. I am sure that you can have access to the report through Transport Scotland.

**Dr Simpson:** That would be helpful.

**The Convener:** We will try to help members with that.

**Willie Coffey:** Is information available on risk assessment and management for EARL? Are issues to do with governance and procurement strategies, which are mentioned in the summary, actively being addressed by the partners? What progress has been made?

It says in the report's summary:

"The EARL project is unlikely to be delivered by the target date of the end of 2011."

Notwithstanding the current delay, has anyone estimated when the project might be delivered and at what additional cost?

**Mr Black:** Given the uncertainty about all the analysis to do with the project, it is unfortunately not possible for us to say more than we have said. The cost estimates were well done at a high strategic level but, until the project is further developed, it will not be possible to give further assurances about the numbers. Likewise, although it is reasonable to conclude that the original deadline for completion will not be attained, we are not in a position to advise by how much the project will be delayed.

**Willie Coffey:** Are the risks that have been identified being addressed and corrected?

**Caroline Gardner:** How the risks can be contained will not be clear until there is a procurement strategy and costs start being tested in the market, but it is not possible to agree and take forward a procurement strategy given wider

uncertainty about the project. We are in a chicken-and-egg situation, because it is not feasible for Transport Scotland or TIE to move the project forward while there is a high level of uncertainty about the availability of funding for the scheme's progress. Given the current position, it is unlikely that much is being done to move the project forward.

**Jim Hume:** Do you agree that for any major transport project the risk decreases over time? Is this too early a stage to review the project?

**Mr Black:** Yes. In essence, at the early stage of a project we expect to see a broad, indicative cost, a comparatively small amount of which is firm, because none of the contracts has gone to market. As a project proceeds and more of the cost is known because bids have been received and tested, the risk element of the indicative cost might reduce. That is the normal profile that we would expect. As I hope I have indicated, the trams project is well through that process, but EARL is well back in the process.

**Jim Hume:** So you agree that this is an early stage to review the project.

**Mr Black:** Yes.

**Margaret Smith:** I want to pick up on a point that Caroline Gardner made about a procurement strategy. The two issues appear to be governance and procurement. Are those issues irrevocably linked? Caroline Gardner said that she could not see progress on a procurement strategy because of the other problems. Who takes decisions on the procurement strategy? Why can progress not be made on it, even if efforts are continuing to pull people together round the table with respect to governance? Are the two issues fundamentally linked?

**Caroline Gardner:** Governance and procurement are closely linked. I will clarify what I hoped I said. It is difficult for either Transport Scotland or TIE to make progress on the procurement strategy because of the high level of uncertainty about the EARL project. That said, paragraph 20 of the review states that there is more uncertainty about the project than we would expect at this stage because of the uncertain governance arrangements and the lack of a clear procurement strategy. Over time, risks are managed down by getting more certainty about costs, about the way in which cost or time overruns will be managed and about who will bear the risks.

**Margaret Smith:** So we are back to the fundamental point about the key partners. The Auditor General said that there is no criticism of Transport Scotland and TIE, but I take it that there is at least an implied criticism of BAA and Network Rail. The fundamental issue is ensuring that

people progress the project; if they do not do so, uncertainty and risk will remain and a procurement strategy cannot be implemented.

**Caroline Gardner:** All the partners must agree the governance arrangements in the way that is set out from paragraph 79 onwards. Without agreement about who will play what role in the project, it is hard to work through how key decisions on the procurement strategy, for example, can be taken.

**The Convener:** As colleagues have finished their questions on factual matters relating to EARL, we shall now have a five-minute comfort break.

11:37

*Meeting suspended.*

11:46

*On resuming—*

## Section 22 Reports

### “The 2005/06 audit of James Watt College”

#### “The “2005/06 audit of Inverness College”

**The Convener:** Agenda item 5 is on section 22 reports. We will discuss recommendations in private, but members may briefly highlight recommendations and ask questions about facts.

**Caroline Gardner:** I will briefly introduce the reports. We will then be happy to answer members’ questions.

Section 22 reports are the mechanism by which the Auditor General can bring any issues that arise from the audits of public bodies to Parliament’s attention. We routinely report on section 22 reports to the Audit Committee so that it knows that they have been produced and so that it has a chance to decide on any resulting action that it wants to take.

This year, the AGS has made two section 22 reports on further education colleges: one was on Inverness College’s accounts; the other was on James Watt College of Further and Higher Education. Both reports relate to the financial year that ended on 31 July 2006.

The Inverness College accounts are not qualified, but the auditor has again drawn attention to the college’s status as a going concern. Some members will know that it has experienced financial difficulties for some time and that we have issued section 22 reports on it every year since 2000-01. Following the report on the college’s 2004-05 accounts, the previous Audit Committee held an inquiry, in May 2006, and issued a report with recommendations for the college and the Scottish Further and Higher Education Funding Council.

During the period on which we are reporting, which ended on 31 July 2006, the college incurred a deficit of around £0.7 million on its income and expenditure account, which was equivalent to around 5 per cent of its income for the year. The accumulated deficit at that point was £3.5 million. During 2006, it undertook an efficiency exercise with the funding council’s support, which led to the production of an action plan and a new financial recovery plan. The funding council continues to support the college in putting that into effect. We understand that although the college has forecast a deficit in the current year after restructuring costs have been taken into account, it has forecast a small underlying surplus from its operations. Our auditors continue to monitor the position in the current financial year, which is well under way.

Similarly, James Watt College’s accounts are not qualified, but the auditor has drawn attention to the college’s position as a going concern. It incurred a deficit of nearly £3.9 million on its income and expenditure account, which was equivalent to 10.5 per cent of its income and led to an accumulated deficit of £5.3 million. In July 2006, its bankers declined to renew its overdraft facility. The funding council then agreed to provide advances of grants, totalling £3 million, between July and September 2006 to provide the cash flow to keep the college running. In return, the funding council required the college to work with the funding council’s further education development directorate to identify the underlying reasons for the financial problems. The directorate reported to the college in December 2006, and the college accepted the action that it recommended. After consulting its staff, the college developed a financial recovery plan that identified expected savings of around £1.6 million in 2007-08 and cash flow projections that show a small cash reserve by 2010-11. The funding council continues to support the college. A new acting principal was appointed in October 2006 and a new chair of the board of management was appointed in December 2006.

It is worth noting that both section 22 reports relate to the 2005-06 financial year, which, as I said, ended on 31 July last year. The reports were laid before Parliament in March this year as usual, but this is the first opportunity we have had to brief the Audit Committee. The 2007-08 position will be covered as part of a wider review of the FE sector that we plan to publish at the turn of this year. That will cover the issues that the section 22 reports concern, with the wider picture of how the FE sector looks.

I am happy to answer the committee’s questions.

**Andrew Welsh:** Inverness College is an old story—we have been here before. You said that a new financial recovery plan has been produced. How does it differ from the previous financial recovery plan or the one before that?

**Caroline Gardner:** As you have identified, this is work in progress. Some fairly significant changes in management occurred at Inverness College following the Audit Committee’s inquiry in May 2006. A new principal took up post at that point, which was towards the end of the 2005-06 financial year, on which we are reporting.

The recovery plans have been subject to a process of updating as the restructuring changes have taken place. The current plan forecasts a small surplus on operations for the current financial year. At this point, the best thing we can do is say that we will report to the committee on that once our auditors have started their financial

audit work for 2006-07. That financial year finishes in a month's time, give or take a couple of days. The report that members have looks back some way, because of the vagaries of the Parliament's timetable.

**Andrew Welsh:** So we can soon check against delivery?

**Caroline Gardner:** Exactly.

**Jim Hume:** The financial recovery plan for James Watt College suggests that a small cash reserve will be achieved by 2010-11. Given that a new acting principal and a new chair of the board of management have been appointed, how confident are you that the college will break even by 2010-11?

**Caroline Gardner:** The answer is similar to that to Mr Welsh's question. The section 22 reports are about the position at the end of the previous financial year. Our auditors are monitoring that now, but the current financial year ends in just a month's time, so it makes sense to wait for the outturn at that point rather than to second-guess plans that were put in place up to 12 months ago.

**Jim Hume:** When will you see the accounts for this financial year, which is about to end?

**Caroline Gardner:** We plan to produce for you at the turn of this year a report across the further education sector. That will pick up the financial health of the sector as a whole and specific colleges that have had problems, such as Inverness College and James Watt College, to assure members about the outturn position and to identify any new problems that may have emerged in other colleges since the end of the previous financial year.

**Dr Simpson:** The plan at James Watt College is to produce a small cash reserve by 2010-11, which is fine, but a deficit will continue to accumulate between now and then. Unless a big change occurs, even with the expected savings of £1.6 million in 2007-08, a further deficit of £2.3 million will be incurred. That will be on top of the existing deficit of £5.336 million and whatever deficit is incurred in the current financial year, which is as yet unaudited—I assume that it will be at least £2.5 million because savings were not expected. We are talking about a deficit that will amount to 25 per cent of annual expenditure by the time cash savings begin to be generated. Do I have that reasonably square in my head?

**Caroline Gardner:** That is reasonably square. The challenge for the college is to remove costs or generate income in a way that brings its recurring income and expenditure back in balance while working with the funding council to agree how the accumulated deficit, which may need to increase

to take account of matters such as restructuring costs, can be managed.

The funding council agreed emergency funding in 2006-07 to keep the college in operation. The recovery plan needs to take account of both requirements: the income and expenditure balance and the accumulated deficit. The plan is for that to start to generate a cash surplus by 2010-11. The way in which the accumulated deficit is dealt with is also subject to discussion with the funding council.

**Dr Simpson:** As the deficit seems to be approaching £10 million, and as there are unquantified restructuring costs on top of that, which might affect any eventual savings, it seems that someone will at some point ask for some massive debt to be written off. I cannot see how this can be done; is it possible for an organisation such as an FE college to work down a deficit that is 25 per cent of annual expenditure?

**Caroline Gardner:** Bold figures such as those suggest that there is a significant problem to be managed. The council has put in place anticipated savings for this financial year, in advance of the financial recovery plan. We have not yet seen how those two things will interact and affect the accumulated deficit. That is always the difficult question around recovery in such situations. The answer is to see what the 2006-07 outturn looks like and what signals that sends for the future recovery plan.

**Dr Simpson:** So we will come back to that in the spring.

**Caroline Gardner** *indicated agreement.*

**Willie Coffey:** I am sure that we want both colleges to get back on an even financial keel. Is any account taken in the recovery plans for the two colleges of the impact of the measures on teaching and learning, or is that outwith the scope of this kind of analysis?

**Caroline Gardner:** That is very much part of the funding council's focus when it works with individual colleges. It is trying to achieve not just financial recovery, but financial recovery that allows the college to keep delivering services to students and employers in the local area, which forms part of the overall strategy for FE in keeping the economy of Scotland developing.

Colleges' approaches will differ. The question for Inverness is how a college in a rural area can deliver services flexibly but cost-effectively. The questions for James Watt College are different. The importance of delivering services is the focus of the funding council's development directorate when it agrees improvement and recovery plans.

**Willie Coffey:** I take it from that that the recovery plans do not indicate any adverse impact

on learning and teaching. I am sorry to probe you on that.

**Caroline Gardner:** The plans aim to manage the impact. It is difficult for us or for the funding council to say that there will be no impact; it is a question of how it is managed, taking into account the available resources and the number of students in the colleges' catchment areas.

**Stuart McMillan:** I stay in Greenock, not too far from James Watt College. I know how important the college is to the local community, economically and socially. There have been many problems at the college in recent years, and letters from concerned academic staff and students have highlighted various issues.

You will report on the financial health of the whole FE sector. Are you able to tell us which financial elements of the funding council you will examine?

**Caroline Gardner:** This will be our third overview report on the further education sector since 2000. The aim for all such reports is to pull together the accounts of all 44 colleges—it is 43 now, I think—to give a picture of the health of each of them and the trends across the sector. We are considering colleges' overall financial performance, how they are performing against the funding council's indicators of financial health and other aspects of the quality of the further education that they exist to provide. We can give you copies of the previous report, for information, if that would be useful. The aim is to pull together a picture for the whole of Scotland rather than ask you to look at 40-odd separate sets of accounts.

**Stuart McMillan:** A letter that I received says:

"something must be done about the SFC and the rules governing college principals, who become power mad dictators as soon as they are appointed."

Will you audit the Scottish funding council and try to establish what its role is, what its function should be and is, and how it manages the funding that goes to colleges and the likes of the so-called power-mad dictators?

12:00

**Caroline Gardner:** I could not possibly comment on the point about power-mad dictators.

**The Convener:** If you could find a measure for power madness, perhaps it could be widely applied.

**Caroline Gardner:** I hope that that would not be necessary, convener.

We have considered governance in the sector several times, not just in the previous overview reports that I mentioned but in relation to Inverness College and, before that, Moray

College, where there were also problems. That throws up questions about the governance of colleges and the relationship between the funding council and the Executive.

I am sure that you are familiar with the report on James Watt College that the funding council's further education development directorate published in December 2006. That report identified questions about the role of the principal, the quality of the next tier of management, and the strength of the board of management. That is a common pattern where such problems have arisen. We will refer to the findings of our previous work and the funding council's work, but we will not directly consider the matter in the report that we will publish around the turn of the year. It is more a question of looking for patterns of warning signals before problems emerge.

**Mary Mulligan:** Your report on James Watt College states:

"A new Acting Principal was appointed in October 2006".

Is he or she still acting principal?

**Caroline Gardner:** I do not know. We will update you on that in the overview report on progress at James Watt College and Inverness College.

**Mary Mulligan:** The previous report mentioned the importance of having a principal who gives a lead. I wonder whether there is an issue about establishing a permanent position.

**Caroline Gardner:** You are right about the importance of the principal. I do not know the current position at the college.

**Andrew Welsh:** The situation is worrying. Without bank overdraft support, it is simply advance-fed grants and anticipated savings, which might not be achieved, that will produce a small cash surplus in four years' time. This must be one of the most serious cases before us. Is it possible for the committee to be kept informed as the results come out?

**Caroline Gardner:** When the committee meets again in September, our auditors will have just started their audit work for the financial year that is about to finish. We can certainly give you an informal briefing on the findings from that work then, and let you know when the audits will be completed.

**Andrew Welsh:** That would be appreciated.

**The Convener:** As agreed, we will move into private session for the remaining items.

12:03

*Meeting continued in private until 12:11.*





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