

# **AUDIT COMMITTEE**

Wednesday 30 April 2008

Session 3

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## AUDIT COMMITTEE

### 8<sup>th</sup> Meeting 2008, Session 3

#### CONVENER

\*Hugh Henry (Paisley South) (Lab)

#### DEPUTY CONVENER

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

#### COMMITTEE MEMBERS

\*Claire Baker (Mid Scotland and Fife) (Lab)  
\*Willie Coffey (Kilmarnock and Loudoun) (SNP)  
\*George Foulkes (Lothians) (Lab)  
\*Jim Hume (South of Scotland) (LD)  
\*Stuart McMillan (West of Scotland) (SNP)  
Andrew Welsh (Angus) (SNP)

#### COMMITTEE SUBSTITUTES

Derek Brownlee (South of Scotland) (Con)  
James Kelly (Glasgow Rutherglen) (Lab)  
Iain Smith (North East Fife) (LD)  
\*Sandra White (Glasgow) (SNP)

\*attended

#### THE FOLLOWING ALSO ATTENDED:

Mr Robert Black (Auditor General for Scotland)  
Irene Coll (Audit Scotland)  
Angela Cullen (Audit Scotland)  
Barbara Hurst (Audit Scotland)  
Mark MacPherson (Audit Scotland)

#### CLERK TO THE COMMITTEE

Tracey Reilly

#### SENIOR ASSISTANT CLERK

Joanna Hardy

#### ASSISTANT CLERK

Rebecca Lamb

#### LOCATION

Committee Room 1



## Scottish Parliament

### Audit Committee

*Wednesday 30 April 2008*

[THE CONVENER *opened the meeting at 10:02*]

### Decision on Taking Business in Private

**The Convener (Hugh Henry):** I welcome members, the press and Audit Scotland staff to the meeting and ask everyone to ensure that mobile phones are switched off.

I have received apologies from Andrew Welsh, for whom Sandra White is substituting this morning.

Under agenda item 1, I ask members to agree to take agenda item 5 in private. Are we agreed?

**Members** *indicated agreement.*

## “Financial overview of Scotland’s colleges 2006/07”

**The Convener:** The second item on the agenda is the Auditor General for Scotland’s report “Financial overview of Scotland’s colleges 2006/07”. The issue has significance throughout Scotland. I invite the Auditor General to brief the committee.

**Mr Robert Black (Auditor General for Scotland):** Thank you, convener. I will be assisted in this briefing by Barbara Hurst, who will be master—I am not sure if one says mistress these days; I will say master because one says actor—of all the detail with the team.

The “Financial overview of Scotland’s colleges 2006/07” was published on 24 April. I previously published a financial overview of the college sector in December 2003—it is not something we do every year, but we occasionally shine the spotlight on how the sector is performing for the benefit of Parliament and the committee in particular. The commentary on financial performance is drawn mainly from the reports by auditors in each of the 39 incorporated colleges, together with information that is held and supplied by the Scottish Further and Higher Education Funding Council.

My previous report related to the 2001-02 financial year, which is going back a bit. At that time, the sector was only just beginning to emerge from a period of severe financial difficulty. I am pleased to say that, since then, the sector has shown a significant improvement in its overall financial position. Many more colleges are reporting operating surpluses, and the overall surplus held by the sector has increased significantly. That does not mean that there are not still some significant financial challenges, which Barbara Hurst will touch on in a moment.

Of the 39 colleges, 35 reported operating surpluses in their accounts. That compares favourably with the position in 2001-02, when only 24 colleges achieved operating surpluses. The overall surplus on colleges’ income and expenditure reserves had grown to £98.9 million by July last year. However, as we say in the report, two colleges account for more than 40 per cent of that.

Barbara Hurst will outline some of the key findings in more detail.

**Barbara Hurst (Audit Scotland):** Set against that relatively positive picture of college finances, four colleges—Edinburgh’s Telford College, Elmwood College, James Watt College and North Glasgow College—reported operating deficits totalling £1.9 million. However, with the exception

of James Watt College, they had sufficient reserves to cover those deficits. The Auditor General has produced two section 22 reports on the 2006-07 accounts of James Watt College and Kilmarnock College. Those have only just been laid before the Parliament, so we will bring them to a future meeting. Six other colleges that have been the subject of section 22 reports in the past five years have, for the most part, improved their financial performance.

Part 2 of the report explains that the overall improvement in financial performance is down to a number of factors. First, there has been an increase in public sector funding. Core grant funding has increased since 2002-03 by around £79 million, in cash terms, to £355 million in 2006-07. Capital funding has increased by £67 million in cash terms over the same period. While there has been some funding for growth in student activity, it has not been substantial. As a result, colleges have been able to concentrate on improving their overall financial position. The Scottish funding council launched a financial security campaign in 2002 and provided associated, ring-fenced funding of around £38 million to support that. In 2002, it launched its further education development directorate, which works largely through peer support. Colleges can draw on the support and experience of their peers in the sector. We spoke to people in different colleges who indicated that they appreciated that support, particularly when dealing with difficult issues or challenges.

Although the improved financial position is encouraging, part 3 of the report outlines challenges for the sector over the next few years. First, while the overall funding that is allocated to colleges will not decrease over the period of the most recent spending review, the increases of recent years will not continue at the same level. The focus now for the college sector will have to be on financial sustainability. Colleges will need to respond to cost pressures associated with limited increases in public sector resources. Other funding sources and income streams are also likely to change, with reductions in European funding and uncertainties surrounding income streams from Scottish Enterprise and Highlands and Islands Enterprise due to the recent structural changes in those organisations. In addition, as we outline in the report, many colleges are proposing major estate or campus developments. That will be a significant area of spend, which presents management and financial challenges for the sector. Our report describes how some estate developments are linked to several colleges forecasting deficits in the next few years. One development that may help to alleviate that is sector-wide procurement. Other sectors in the public sector are aiming to create centres of excellence, and a centre of expertise for the

college and university sectors has been established. However, progress has been slower than anticipated, and concerns about the level of subscription fees required to fund the centre's activities will need to be addressed if the sector is to secure the anticipated efficiencies.

Colleges operate within relatively narrow margins. Our analysis found that, across colleges, the average operating surplus has grown in the past few years to around 3 per cent. However, that is relatively low and may not provide sufficient year-end flexibility. The potential consequence of operating within such narrow margins is that even relatively small changes in income or expenditure can move a college from an operating surplus to an operating deficit. That is shown in the report.

Auditors found that the governance and management arrangements were generally sound both in the funding council and in individual colleges, although some relatively minor weaknesses were identified in some colleges.

We highlight in our report two areas in which the committee has expressed interest previously. First, college boards of management should ensure that they have members with recent, relevant financial experience. Secondly, colleges should prepare good-quality draft accounts so that the audit can be completed smoothly and on time. That sounds very bureaucratic, but it is not meant to be. The issue is not one of auditors being under pressure. Rather, it is about the capacity of the finance function of colleges; the avoidance of additional fees should accounts not be presented in a good way; and, most important, the need for boards of management to have access to good sets of accounts and audit reports, so that they can consider their own role in the management of the college.

The report highlights two colleges where there have been significant delays in the process. We also found that the accuracy of colleges' financial forecasts could be improved. That is important, because inaccurate forecasts could result in college boards of management making the wrong decisions or in the funding council providing support to the wrong colleges.

The report is positive, in that we found that colleges are in better financial shape and that their overall financial performance has improved. That has been achieved through a combination of increased funding and peer support. The sector has genuinely learned some lessons from the difficulties that the previous Audit Committee highlighted. However, the sector faces a number of challenges, and it will have to respond to the cost pressures that are looming before it.

As the Auditor General indicated, we are happy to take questions on the report.

**The Convener:** I want to ask about the issue of governance, which you touched on, and about leadership. From my local experience, I am struck by how, in the wider Renfrewshire area, leadership is critical to the health and wellbeing of further education colleges. In the past, there were significant concerns about the financial performance of Reid Kerr College in Paisley and about the quality of the product that the college was offering. Then a new principal was brought in. Under Joe Mooney, the college has been transformed. There is a vitality about it. It is outward looking, positive, well run and well managed. There is a real buzz about the place. Just down the road in Greenock is James Watt College, which had been regarded traditionally as a dynamic, outward-looking college and a trendsetter. In the past few years, it has almost collapsed.

I am struck by the critical role of the principal in both those cases. That must surely apply more widely. A good principal has influence in ensuring that a college is well run and well managed, and that it sticks to its accounts properly and improves the quality of the service that it provides to students. What can we take from the report about the influence of the principal?

The second issue affecting governance and leadership is college boards, which Barbara Hurst also mentioned. I get a feeling—I may be wrong, as this may be a subjective view—that boards are often merely a fig-leaf to allow the principal to do what the principal wants to do. Are boards perhaps incapable of holding to account and challenging the principal to ensure that the college is properly governed?

10:15

Where boards have such weaknesses, what is the solution? Do we simply need to ensure, as has been suggested, that boards have sufficient numbers of people with recent financial experience? Do we just need board members who are diligent enough and able enough to look at the detail and to challenge? Do questions need to be asked about the methods by which board members are appointed? Frankly, to an outsider, it looks as though the board is appointed by the principal and there is no objectivity or accountability in the wider process. That is a worry, given the substantial amounts of public resources that are being invested in the sector.

I would be interested to hear the Auditor General's thoughts on those issues.

**Mr Black:** I will attempt to reply to the convener's questions and thoughts on those extremely important general issues before inviting Barbara Hurst to respond.

I absolutely agree that leadership is an important issue not only in FE but across the public sector. Against that sense of the importance of leadership, we carried out a review of leadership programmes across the whole public sector. That review concluded that there was a lot of activity on leadership in the Scottish public sector but that a lot more needed to be done to develop effective leadership capacity.

It is difficult for auditors to comment on a qualitative issue such as leadership in the FE sector. However, it is not unfair to say that, when I have previously laid before the Parliament the occasional report on the problems and failings of individual colleges, those colleges have had issues of effective leadership. Consideration of those matters will, I think, be on the record of the meetings of the Audit Committee in previous years. Issues of leadership have been very important.

The previous Audit Committee also expressed concerns about the effectiveness of boards and, for example, about how their members are appointed and how the boards are refreshed. In a report that was presented to Parliament some time ago, the committee commented on some of the risks that are associated with the fact that college boards are appointed locally and basically recreate themselves at that level. Accordingly, the role of the principal and the chair was seen to be critical in ensuring that effective appointments are made.

Those findings were taken seriously by the Government at the time. The review that was launched considered how the FE sector was overseen by the then Scottish Executive and the role of the funding council. Certain changes were introduced, but the fundamental governance arrangements did not change. It is really for the current Government to explain its views on those matters but, in view of the governance issues that still exist, part 4 of our report—from page 27 onwards—tries to capture those issues.

I must offer one plea in mitigation of the audit process, in that we have a bit of a difficulty with the colleges. It is generally true throughout the Scottish public sector that the smaller organisations—this is not a criticism of the people who run them or who sit on their boards—tend to have greater risks because they do not have the capacity. That might be said to be relevant to Western Isles NHS Board, which we will consider again later this morning. Given that some of the colleges are comparatively small, the amount of audit resource that we can put into them is quite limited because, otherwise, the approach would become disproportionate and the fee burdensome.

Against that background, we work as closely as we can with the Scottish funding council and seek

assurance from it about its oversight of the colleges. It is important to mention to the committee that, in our judgment, the funding council's governance and management arrangements are, in general, effective. Over the past few years, it has introduced many more initiatives to engage with the college sector, which we capture on page 27 of our report. They include a requirement for annual financial returns to be provided, which must cover the underlying position of the business. Annual forecasting returns must also be submitted, and the funding council makes regular visits to all the colleges—each college is visited two or three times a year. Financial performance indicators have been put in place and cost benchmarking data are provided. The funding council is engaged in a great deal of activity with the colleges, so they are not alone; the college system is getting more support than it used to.

**Jim Hume (South of Scotland) (LD):** Overall, the position is improving, which page 4 of the report says has been achieved “by increases in funding”. However, in paragraph 95 on page 20 concern is expressed about the fact that funding will not continue to increase by as much as it did over the past five years. Paragraph 105 says that Scottish Enterprise funding is uncertain, as Barbara Hurst mentioned. Certain colleges—those that focus more on skills development, I presume—do a great deal of co-operative work with Scottish Enterprise. Do we know what impact the restructuring of Scottish Enterprise will have on the funding of those colleges, or is the position still uncertain?

**Barbara Hurst:** It is still too soon to say. In our report, we say that there is a risk of colleges being affected, but we do not know what will happen. As a result of the restructuring, which will involve some of Scottish Enterprise's responsibilities being transferred to councils, certain colleges—some will be more affected than others—will have to rely on employment contract-type training programmes. We flag up the issue and point out that although some colleges forecast that they will continue to receive increased funding from Scottish Enterprise, they should be careful because we do not yet know how the situation will play out. We should watch that space.

**George Foulkes (Lothians) (Lab):** This is an excellent report that shows the value of the whole process. The colleges' financial performance has improved under pressure from the committee and, above all, from the Auditor General and his staff. That is extremely encouraging.

I have two questions. Page 27 deals with corporate governance, which I have some worries about, and mentions that some colleges have boards that do not have members with recent, relevant financial experience. As Robert Black

said, we know from our investigation into Western Isles NHS Board that it is extremely important to have board members who hold the executive to account. When we consider our approach to the report later in the meeting, we ought to take that issue into account.

My first question is about appointments to boards. I get the impression that there is a bit of a self-perpetuating situation in colleges, to the extent that the principal has some responsibility for suggesting who should be appointed as governor. That creates problems, given that the governors must hold the principal to account. Perhaps the Auditor General or one of his staff could comment on the independence of governors.

My second question relates to page 21, which mentions the potential loss of charitable status for colleges that is under consideration. The law of unintended consequences has come into effect in the context of charity law. The fact that the Office of the Scottish Charity Regulator questioned the charitable status of John Wheatley College but gave a private school—I think it was Dundee high school—a clean bill of health seems to go totally against the spirit of the legislation that was considered by the Scottish Parliament, as I understand its purpose; I took part in the debate on the reform of charity law elsewhere.

Paragraph 109 states that the Scottish Government has made a commitment to introduce legislation to resolve the situation. Does the Auditor General or one of his staff know where we are on that? It would be outrageous if public colleges that provide educational opportunities for some of the poorest people in the land did not continue to have charitable status while private schools that provide privileged education for some of the richest people in the country did. I invite comments on those issues.

**Mr Black:** I acknowledge Lord Foulkes's concerns about the performance of the governance function. It is not really possible for us to give members a strong evidence base for what is happening in colleges. Our general impression from the auditors is that most colleges have people who have recent financial experience and that the standard of governance is good. Nevertheless, procedures might not be as robust as they should be in some colleges—for example, if the risk register, fixed-asset registers and compliance with the code of corporate governance are not in place.

As I believe I mentioned earlier, the funding council is much closer to the issues than I am. It is therefore much better placed to comment on them, not least because our engagement at college level is quite limited and we rely heavily on good communication with the funding council.



**The Convener:** George Foulkes and I have raised issues of governance with you. I described boards as a fig-leaf for many principals. They appoint their board, so they can appoint reflections of themselves and, if they wish, they can appoint people who are less willing to give them a hard time by holding them to account. That system is completely unsatisfactory, and there is no independence or objectivity in it, as far as I can see.

You mentioned that there was a review of the further education sector but there has been no fundamental change. We might wish to return to the review and ask about what is happening with it, given that an element of the public sector is subject to less scrutiny and accountability than other elements of the public sector, which cannot be right.

**Murdo Fraser (Mid Scotland and Fife) (Con):** I want to ask about the points that are mentioned in paragraphs 23 to 27 of the report. I am rather concerned to see from the report—if I am reading it correctly—that four colleges received qualified audit opinions because of the way in which they treated their pension liabilities, despite the fact that they seemed to treat them in the same way as many other colleges treat them. The problem seems to have arisen because of a difference in the approach taken by the external auditors, which appears to have been somewhat less than satisfactory. Do you agree that such an approach to audit for those colleges is unsatisfactory?

**Mr Black:** The approach is not terribly satisfactory. Our difficulty is that the accounting standards allow different treatments, although we have encouraged the sector to work with us to come to a shared, consistent approach. However, the situation does not significantly affect what you might call the going-concern position of colleges, although I agree that it is not terribly satisfactory. Perhaps Barbara Hurst or one of her team could attempt to explain.

**Barbara Hurst:** Mark MacPherson could give us an update and explain in a bit more detail.

**Mark MacPherson (Audit Scotland):** Members will appreciate that accounting treatment is quite a technical issue. We appoint auditors to provide an independent opinion, so it is perfectly reasonable for different auditors to come to different opinions. However, as the Auditor General said, it is not terribly satisfactory to have such variation across a sector.

We have convened meetings with the individual colleges that were affected along with other experts in the sector such as auditors, and we are using our experience to resolve the situation. The discussions are continuing. We are also engaged with the funding council because it might have a

role in facilitating some consistency of approach. We hope that such engagement will have a good outcome. That is as far as we have got at the moment.

**Murdo Fraser:** When is the situation likely to be resolved?

10:30

**Mark MacPherson:** We cannot say with certainty when it will be resolved. There are still issues to be discussed and opinions to be resolved by different people. However, we can, of course, keep the committee updated on the matter.

**Murdo Fraser:** Yes. Thank you.

**The Convener:** What would be required to ensure consistency? You mentioned that a degree of flexibility is open to people, but it seems rather absurd that different people can treat the same thing in totally different ways. What would be required to ensure that each college and each set of auditors applied the same method?

**Mr Black:** We have suggested to the funding council that it would be helpful if it introduced a clear sector-wide policy to which the auditors could respond, but that is one of the matters that has not yet been finally concluded with the sector.

**Stuart McMillan (West of Scotland) (SNP):** Barbara Hurst mentioned two reports—on James Watt College and Kilmarnock College—that have been laid before the Parliament. What are they about? Are they section 22 reports?

**Barbara Hurst:** They are. They have been laid with the accounts of the two colleges and highlight for the committee issues that arose from the accounts. It is unfortunate that we could not discuss them with the “Financial overview of Scotland’s colleges 2006/07”, but they have just been laid, so the papers would not have been available in time for the committee.

**Stuart McMillan:** Do they relate to 2006-07 or 2007-08?

**Barbara Hurst:** They relate to the 2006-07 accounts. We mentioned them in the report. They will come to the committee.

**Stuart McMillan:** I was not sure whether they were in addition to what is mentioned in the report.

**Barbara Hurst:** No. There is a more formal process to ensure that we bring matters to your attention.

**Stuart McMillan:** I agree with what the convener said about James Watt College. Around a year and a half ago, I spoke at a rally in Greenock in support of the lecturers, staff and students of that college. I realise the importance of

good, strong leadership in it and in all the other colleges in Scotland, and the importance of James Watt College to Inverclyde's economy.

I am heartened by case study 1 in the report, which is on James Watt College. It mentions the forecast surpluses for the forthcoming three years. I am sure that many people in the Inverclyde area and the lecturers and students at the college will be happy with what that study says.

I found paragraph 42 of the report, which deals with the buyout of the West Lothian College private finance initiative contract, interesting. Paragraph 49 states:

"The auditor concluded that processes were appropriate and adequate to permit the college and SFC to demonstrate that the buyout of the PFI contract delivered best value for public money."

I was heartened to read that, but a wee bit surprised by an aspect of the contract. I refer to the second bullet point in paragraph 42. The agreement specified that the PFI provider would still own the facility at the end of the contract. I am delighted that the buyout has taken place, but has any more information about it come out?

**Mark MacPherson:** I do not think that we can add anything to what is described in the report; the position has not changed. It is up to the college to move on and work according to the position that it is in.

**Sandra White (Glasgow) (SNP):** Overall, the report is very good. The deficit has moved to a surplus, which is excellent.

I have a couple of questions, one of which follows on from the questions about college boards that were asked by the convener and George Foulkes. Barbara Hurst mentioned major estate and campus developments, or buyouts and amalgamations. I have concerns about what will happen in the Glasgow area in particular. Glasgow Metropolitan College, the Central College of Commerce, Glasgow College of Nautical Studies and Stow College are amalgamating, so that they will be under one umbrella.

Has Audit Scotland or the Scottish funding council had any input on the roles of those colleges' boards? It has been mentioned that the sizes of the boards are different. What role will the boards have in the amalgamation? My question touches on Murdo Fraser's comment on the situation. How will things work if the colleges are amalgamated, given that they have different pension funds and audit arrangements? How will those things be manageable when the amalgamation eventually takes place?

**Mr Black:** One benefit of amalgamation is that the new body will have the critical mass to ensure that it has strong finance and leadership skills and

stronger boards. However, the funding council will be much better able to tell you the current position and the thinking about the composition of the bodies.

On pension funds, it is important that we do not mislead you. The pension funds exist on a consistent basis. Generally speaking, they are part of the local authority pension scheme. The point that has been raised concerns how they are accounted for at a small number of colleges that differ from the rest. Therefore, it is highly unlikely that the pension arrangements will be significantly affected by the amalgamation of the colleges.

**Mark MacPherson:** Our understanding is that the option is a shared campus and not an amalgamation of the colleges. What happens when the colleges share a campus is a matter for their consideration, but I make it clear that the proposal is for a shared campus rather than an amalgamation or merger.

**Sandra White:** I have heard talk in the colleges of amalgamation. We will see what happens. Given what the Auditor General said, perhaps it would be a good idea for the committee to get a report from the funding council.

George Foulkes asked about charitable status, but I do not think that we got an answer on that. Perhaps you could clarify the position.

The European regional development funding that colleges receive has been cut from £1.1 billion to £540 million. The colleges say that they will receive funding based on social deprivation, but I do not know how that will be determined. If such funding is focused on areas that are more socially deprived, not all the colleges that benefit at the moment will receive it. How will that work?

**The Convener:** We can contact the Minister for Parliamentary Business to find out about the parliamentary process and charities. I do not think that it is fair to ask the Auditor General and his colleagues from Audit Scotland about that.

Do you have any comments on European funding?

**Mark MacPherson:** The figures that Sandra White quoted are for the whole of Scotland. Obviously, colleges receive a proportion of that funding. As we say in the report, some colleges receive more than others because they are better placed to use the funding in line with European aims and objectives.

Colleges across the piece forecast a reduction in European funding, with the exception of a couple of colleges that receive relatively small amounts. The challenge will be for colleges to seek alternative means of raising funds to maintain the programmes that they have run with European funding up to now.

**Claire Baker (Mid Scotland and Fife) (Lab):** I seek clarification of paragraphs 95 and 96 of your report. Paragraph 95 mentions

"an average increase of 0.9 per cent per year ... over the next three years".

Can you break that down into annual percentage increases or decreases? Are there any implications for the funding of the colleges?

Secondly, can you give us more information on how the sequence of events that is described in paragraph 96 came about? It seems to be back to front. I do not know whether that is to do with the timing of the budget proposals in 2007, or whether there were other problems.

**Mark MacPherson:** On your first question, we cannot give such a breakdown because it is for the Scottish funding council to decide how much is released in each year. The funding council is better placed to advise you on that.

On your second point, the funding council requires colleges to submit forecasts in June each year for that year and the next three years. The timing depends on when the Government announces its spending review proposals. Things were not deliberately done out of kilter. Obviously, it is for the Government to decide when to announce its budget.

**The Convener:** Paragraph 95 of the report states:

"The funding increases experienced in recent years will not continue."

Paragraph 96 states:

"a number of colleges' forecasts of future SFC funding may be too high."

If that is the case, can we reasonably assume either that deficits will increase or that there will have to be cutbacks in service provision?

**Mark MacPherson:** I do not think that I can answer that. It will be up to individual colleges to decide how they cope with any reductions in increases, which is a bit of a difficult term.

**The Convener:** Given the historical management of funds, would it be possible to retain the present level of service on the basis of reduced funding?

**Mark MacPherson:** If colleges can deliver efficiencies, that would be possible. Again, the onus is on the colleges to try to deliver efficiencies with whatever money they have.

**Willie Coffey (Kilmarnock and Loudoun) (SNP):** I want to pick up on the key issues of governance in the report in relation to risk assessment processes in the colleges and financial planning. This time next year, how will we know whether any improvements have been made

in those areas? Will you revisit the matter and report to us on whether improvements have been made?

You reported that several of the colleges are planning major capital investments over the coming period. You also reported that some colleges are forecasting deficits. Will you clarify whether the colleges that are planning major capital investments are also forecasting deficits? We would be concerned if that were the case.

**Mr Black:** On the first point, on the basis of the audit activity, it would be possible for us to advise the committee on some of the basic issues around compliance with the corporate code of governance; the development of risk management systems; registers of board members' interests; and asset registers. As we said in an earlier exchange, that would not do more than give you a broad indication of how a college is moving. It is difficult for us to keep in touch with how governance is developing in each college. The responsibility is primarily with the funding council to satisfy itself on those matters. As I explained, it makes regular visits at least twice and sometimes three times a year to each college to look at the financial position. It should have a good sense of how the colleges are developing. Therefore, you might want to take up with the funding council the extent to which it can give you an assurance about what is happening, not only now but in the future.

Your second question was about the relationship between forecast deficits and capital programmes, which is interesting. I wonder whether the Audit Scotland team can help us.

**Mark MacPherson:** In paragraph 75 and the following paragraphs, we highlight that seven colleges are forecasting deficits over the next three years. Five or six of them have proposals for major capital developments. We have said that that is the main reason for the forecast deficits. However, I do not think that you can assume that all colleges that are about to undertake major capital developments will be forecasting deficits, because some have built up revaluation reserves that allow them to cover the costs.

**Jim Hume:** I have some concerns. Obviously, we are seeing European funding reduce significantly. It is more than likely that Scottish Enterprise funding will reduce significantly. As a previous local enterprise board member, I know that a lot of Scottish Enterprise money was used to lever in European match funding.

Paragraph 95 of the report says that the Scottish Government's budget is reducing significantly the funding increases to colleges. I hope that we get such a good report in the future.

I have concerns about the pension reserves that are shown in appendix 3. If I read it correctly, there

seems to be a total deficit of £8.436 million in pension reserves, and Borders College and Forth Valley College are both round about £2.3 million in deficit. Is that a ticking time bomb?

**Mr Black:** It is a concern, although I would not use phrases such as “ticking time bomb” at this point. Although the deficits are there, and although they are significant relative to some of the small colleges, at least they are well known and understood.

10:45

**Mark MacPherson:** Paragraph 37, which discusses pension reserves, explains that the way in which accounting treatment changed a few years ago had an impact and created higher deficits in the reserves. However, there has been an improvement over the past few years, so you would hope that the improvement would continue. However, it is not possible to gaze into a crystal ball and know that things will go right. We will continue to monitor the situation, as will the individual auditors in the colleges. If issues arise, I am sure that they will raise them.

**Jim Hume:** There has been a change since 2004-05. Are the pension deficits increasing or are they improving? As you say in paragraph 37, the accounting system has changed over the past three years.

**Mark MacPherson:** The position is improving. When the new treatment was first introduced, the effect was negative. However, as colleges have adjusted to the changes, there has been an improvement, back to the levels that we show in the report. However, we are keeping a close eye on things.

**Mr Black:** The only qualification to that is that we have to consider what is happening in the financial markets. We are talking about funded schemes. If there is an adverse movement, it will be due to factors that are outwith the control of individual colleges. It will be due to what is happening in capital markets and investment markets generally.

**Jim Hume:** But that does not mean that there is not a problem.

**George Foulkes:** I want to follow up on what Jim Hume and Claire Baker have been saying. Scottish Enterprise money is going down; European funding is going down; the new Scottish Government is giving substantially less than the previous Administration—in real terms, the increase now will be a third of what it was; and pensions are in deficit. Taking all that into account, a crisis could be looming.

The previous report was five years ago. Have you any plans to keep an eye on the situation?

Rather than wait another five years, will you do another report next year, or relatively quickly, to ensure that the looming crisis that Claire Baker and Jim Hume fear does not happen? We should do something to avert it.

**Mr Black:** I would add another factor to Lord Foulkes's list—the trend in demographics. There are fewer people in their late teens and early twenties, and they are still the prime client group for further and higher education institutions. That factor has not yet fully bottomed out. Colleges are obviously trying to extend into continuing education markets and into retraining, but nevertheless there is a risk.

At the end of each year, in the normal way, we will have final reports from the auditors and we will have the audited accounts. The Audit Scotland team will monitor that. We would not normally prepare a financial overview each year, but if the signs are that the risks are crystallising or becoming more serious, it is very possible that we will come back to you with a further report sooner than we have planned.

**Barbara Hurst:** We still have not answered the question on charities. That is not because we are being evasive; it is because you have been firing so many questions at us.

We do not know any more than is in the report, which gave us up-to-date a position as we could get at the time of drafting.

**The Convener:** We will ask the Minister for Parliamentary Business about the timescales.

I thank the witnesses for their contributions. Later on today's agenda, we will consider the report again.

## “A performance overview of sport in Scotland”

10:49

**The Convener:** Under agenda item 3, I invite the Auditor General to brief the committee on “A performance overview of sport in Scotland”. We will discuss what action to take later in the agenda.

**Mr Black:** Each year, as part of our work programme, we conduct a small number of studies that attempt to look at what you might call policy areas in Government, where the spend and the expectation of delivery is divided between different types of public agency. We thought that it might be appropriate to do that in relation to sport in Scotland.

The report attempts to outline the structure and funding of sport, which may not be well understood by many people in Scotland, and considers performance against national targets, in so far as we could find reliable performance information.

The report mentions some of the financial implications of hosting the 2014 Commonwealth games and the risks that are associated with staging major events such as the games. I am not suggesting that those risks are particularly significant in relation to the Commonwealth games in Scotland. However, given the type of project, it is right that we should go into the planning of the event with our eyes open, both as auditors and as Government, and acknowledge that the risks need to be managed.

Each year, the public sector spends on average more than £558 million on sport. Most of that is spent on providing and maintaining sports facilities, encouraging participation and supporting individual athletes. Councils are responsible for around 90 per cent of the spending. In addition to on-going spending on sport, almost £300 million of public money has been committed to preparing for and hosting the 2014 Commonwealth games.

The expenditure should make a significant contribution to the three policy objectives of increasing participation in sport, promoting social inclusion through sport and achieving excellence in sporting achievement. Sport can also help people to enjoy healthier lives, address obesity, improve wellbeing and build supportive communities.

We have found that it is not necessarily the case that there is joined-up action across Government and between central and local government. For example, only half of the 32 councils have publicly available sport strategies and only four of those have performance measures that align with key

national objectives. In the report, we suggest that the Government's development of an outcomes-based approach to performance management provides an opportunity to clarify the links between national and local strategies.

The level of public participation in sport in Scotland has declined. In 2001, 49 per cent of adults took part in sport at least once a week, but the figure had dropped to 42 per cent in 2006. Unfortunately, more recent data are not yet available to us. Participation by younger people also falls well short of targets in some instances.

Adult participation, perhaps not unsurprisingly, varies depending upon age, disability, gender and geographical location. For example, exhibit 11 on page 23 of the report shows that, in 2003-04, weekly participation rates were over 50 per cent in most council areas. Five councils had weekly participation rates of 60 per cent or more, but six councils in the west of Scotland had weekly participation rates of 40 per cent or less. The wide variation within Scotland is striking.

Targets to be achieved by 2007 were set for younger people's participation in physical activity and school-based physical education. It is not possible to assess whether those have been met as the data are two years out of date, but the available data suggest that those targets are not likely to be met. In 2005, only 5 per cent of primary schools provided a minimum of two hours' physical education each week. Seven per cent of secondary schools provided the minimum of two hours for pupils in the first four years, but none met the target for older pupils. That does not compare well with England where, on average, 70 per cent of pupils aged 14 to 16 and 30 per cent of pupils aged over 16 receive at least two hours of physical education each week.

Better progress has been made on the aim of achieving excellence in sporting achievement—what might be called elite athlete performance. As the report says, 283 Scots were medallists in international competitions by 2007, against a target of 250. That is encouraging for our representation at the Commonwealth games.

Moving on briefly to sporting facilities, councils have a responsibility to provide such facilities and, in Scotland, we have about 7,000 of them. Between 2002 and 2007, councils spent £385 million on capital projects to build and improve facilities such as swimming pools and outdoor pitches. Funds that come from the Scottish Government and the national lottery funds are also used to improve sports facilities. For example, the national and regional sports facilities strategy has committed £48.5 million to improving sports facilities. However, as we attempt to show on exhibit 7 on page 15, progress on delivering the strategy is slower than expected. By March this

year, two approved projects had been withdrawn and, of the remaining eight, only four were on schedule to be completed on time.

Scotland has many examples of high-quality sporting facilities, but it is true to say that a large number of the facilities need upgrading. Sportscotland's national audit of sports facilities in 2006 resulted in an estimate that about £110 million a year would be needed for the next 25 years to bring them all up to an acceptable standard. That highlights the need for a national strategic approach to facility planning and investment, which is integrated with the local plans that are developed by local authorities.

The public sector has committed £298 million to the cost of staging the Commonwealth games, with the Scottish Government providing 80 per cent, or £238 million, and Glasgow City Council providing 20 per cent, or £60 million. The arrangements for delivery are at a very early stage, but I thought it important in the report to mention the risks that are involved in staging such events. We have looked at the early experience of planning for the Olympic games in London to identify the main risk areas. The first risk—the one from which it could almost be said that the others flow—is that, because the deadline for the games cannot be moved, there might be significant pressures on costs and quality standards in the effort to stick to the timetable. Robust project and financial management, strong governance and delivery structures, good risk management and effective procurement practices need to be in place. Finally, of course, the proposed legacy plans for the games must be clear about the anticipated lasting benefits and costs, and about who is responsible for delivering them and by when.

I have asked Audit Scotland to monitor progress and, in particular, to keep under review how those risks are being managed. I will arrange to report to the committee in future if there are concerns.

**The Convener:** In your summary, you say:

"Targets for young people's participation are not being met, and adult participation is declining. Performance is better against the target for elite athlete performance."

We all share your aspirations for successful participation at an international level by athletes from Scotland. However, if the price of that is a concurrent decline in participation by young people and adults, that would be profoundly worrying, because it would have not only significant social implications but significant health implications. That is a major challenge for us, because we cannot afford to target only elite athletic performance. Do you have any sense that what you have seen historically is beginning to change, or is this a problem that is being compounded as we go forward?

**Mr Black:** As I mentioned, we struggle a bit because the data are rather out of date. It is possible that recent initiatives are helping to turn the situation round. In a moment, I will ask the team if they have any feel for that.

Sports participation rates in Scotland compare not unfavourably with those that exist across Europe. We have tried to capture that in exhibit 12 on page 25, which shows that Scotland is well into the top half of European countries in terms of the percentage of participation. We are not starting from a poor position relative to other European countries. However, as I think that your question implies, it is concerning that there is a fairly dramatic variation in participation rates between parts of Scotland, with particularly low participation, relatively, in the west of Scotland.

11:00

**The Convener:** Has a mapping exercise been done to examine the links between poverty and deprivation and participation in sport?

**Mr Black:** We could not find any reliable information on that to include in the report, which is why we make no more than a general reference to the possibility of such links. Several factors are involved, including access, quality, affordability and whether the right type of facilities are in place. We have not analysed that.

The team may be able to help with the points about whether better information exists and whether there is any information on the links with deprivation and poverty.

**Irene Coll (Audit Scotland):** On elite athlete performance compared with general participation in sport, elite athlete performance is handled by the Scottish Institute of Sport, which, until recently, received its moneys from lottery funding, so sportscotland has spent relatively small amounts of money on achieving excellence. Paragraph 25 on page 11 states that, in 2006-07, the funding for sportscotland's three priorities totalled £18.2 million, but only £0.1 million of that was spent on achieving excellence. The rest of the money was spent on participation and on what sportscotland calls pathways, which involves getting people to participate in sport and then developing them through the club structure. Until recently, the elite aspect has not received a lot of sportscotland money.

Many people are concerned about the link between low levels of participation in sport and social deprivation, and sportscotland has commissioned research on the issue. Although there is a link between deprivation and lower levels of participation in sport, there are also links between participation rates and gender and various socioeconomic factors, so deprivation is

not the sole reason for lower participation rates. One big issue that sportscotland and others are grappling with is the west of Scotland phenomenon—why participation rates in the west of Scotland are so low compared with those in the rest of the country. Even when we factor in deprivation, it does not provide the full answer. Academics are examining that.

**Murdo Fraser:** The report is wide ranging. I have a couple of questions. I will start with the balance between funding for wider participation and funding for elite athletes. Part of the argument for funding elite athletes is that, by increasing the number of medal winners at Olympic and Commonwealth games, we create role models, which encourages more young people to take up sport. Have you considered that and, if so, did you find any evidence that having more elite athletes helps to increase participation levels in sport, particularly among young people?

**Angela Cullen (Audit Scotland):** We did not go into that level of detail—we did not consider whether links exist between role models and increasing participation.

**Murdo Fraser:** That would be an interesting piece of work, although perhaps it is not for Audit Scotland. It would be interesting to find out whether a link exists, as that would help to justify the spending on elite athletes.

**Irene Coll:** The Scottish Government recently put out for consultation the legacy plan for the Glasgow Commonwealth games, and consultation responses are expected on such issues.

**Murdo Fraser:** I have a question on a completely different subject that the Auditor General covered in his opening remarks: the Commonwealth games preparations. One potentially alarming feature in the background is the huge cost overruns for the Olympic games in London. I read recently that they are the largest cost overruns for any public sector project in history. We do not want a replication of the Olympic games saga in Scotland, with the implications that that would have for the Scottish Government's budget. Paragraph 53 of the report points out:

"As the guarantor of 80 per cent of public funding for the Games, the Scottish Government bears"

the financial risk. What is your sense of the current position?

Clearly, there is potential for substantial cost overruns. In paragraph 53 you state:

"The Government should develop a plan for monitoring the cost and income risks."

In paragraph 56 you state:

"The Scottish Government should develop a framework of timely progress and risk reporting."

The wording and tense that you use suggest that that work has not yet been done. Are the plan and framework to which you refer now in place, or do you know when they will be in place?

**Mr Black:** The Commonwealth games project is at an early stage of development. As we all know, Scotland was successful in securing the games only last November. Since then, there has been a wide range of activity to put in place the basic infrastructure for overseeing the games and managing the programme. In the report, we have described those arrangements, which involve the establishment of a strategy group and a company limited by guarantee. The chief executive was appointed only a few days ago.

In my opening remarks, I said that we are not suggesting for a moment that the risks that we have identified will crystallise. However, it must be in everyone's interest for us to draw attention to the risks that exist and need to be managed. There is a significant difference between the Olympics and the Commonwealth games. Not only are the two events intrinsically different in size, complexity and the challenge that they pose, but the volumes of capital investment in infrastructure are different. As we all know, investment in the Olympic games will be very substantial. The latest estimate of the total cost of the games is in excess of £9 billion. The issue has been considered by the Public Accounts Committee at Westminster.

The infrastructure costs in Scotland are less significant, but they do exist. Glasgow has about 70 per cent of the games infrastructure in place, but £67 million of capital investment—additional investment via the national and regional facilities strategy—is anticipated. In the next few years, there will be a need to watch carefully what happens to construction costs in Scotland. As I have mentioned before—the committee has also touched on the point—there will be a huge volume of construction activity during that period. I refer to construction both for the Olympic games, through to when they are held, and for other major capital projects in Scotland. Construction inflation will need to be watched carefully.

The running costs of the Commonwealth games will be just over £300 million. Clearly, there is a risk of overruns, which is why we say that the highest-quality risk management and financial control procedures need to be in place.

**Murdo Fraser:** You mentioned the potential cost overruns that might derive directly from the London Olympics, not least because of wage inflation in the construction sector and a lack of availability of skilled labour. Are you confident at

this stage that those potential additional costs have been factored into the calculations?

**Mr Black:** It is too early to say how the project will run. The budget for the games provides for a 10 per cent contingency—the sum of £40 million—which is the minimum that would be acceptable in a project that is pushing towards £400 million. Proper provision has been made at this early stage, but the issue will have to be monitored over the next few years.

**Jim Hume:** My question builds on and gives substance to the comments of Hugh Henry and Murdo Fraser on councils' focus when they spend their money. We would expect the money that is spent per capita on sports facilities to correlate with sports participation rates but, perversely, the opposite seems to be the case. Glasgow City Council spends by far the most per capita on facilities but has the worst participation rates. In contrast, Western Isles Council or Comhairle nan Eilean Siar—I think that I have pronounced that wrongly—spends little per capita on facilities but has good participation. I know that there is not just one culture in Scotland—Glasgow is different from the Western Isles, which is different from Shetland, which is different from East Lothian—but it seems glaringly obvious that there has to be a study into councils' focus, and that best practice might be learned one from the other. I would like the Auditor General's view on that.

**Mr Black:** Sometimes, as I might have mentioned in the past, the analysis that we provide in reports raises questions rather than answers them. I think that this is one of those occasions. As was mentioned earlier, it is by no means clear why the numbers vary so significantly in different parts of Scotland. It might even have something to do with the quality of the data that are captured.

**Jim Hume:** There is three years' difference between exhibits 4 and 11, for one thing.

**Mr Black:** We strongly encourage the Scottish Government and the local authorities to address some of the issues, not least through the new single outcome agreements and the development of indicators and portfolios, to allow us collectively to get a handle on the issues.

**Jim Hume:** I think that Irene Coll mentioned that sportscotland is examining the matter. Do we know whether it has a date for reporting to anyone?

**Irene Coll:** Sportscotland has academics from Stirling University examining the situation, and I think that they anticipate producing further work by the end of the year.

**Jim Hume:** Is that work based purely on the west of Scotland?

**Irene Coll:** No. The original study examined regional participation rates and why they varied, and tried to find correlations between the various factors that I mentioned earlier. Following on from that, the academics said that we needed to get to the bottom of more fundamental questions. My understanding is that the academics have been commissioned to do further work and are due to report at the end of the year. We could clarify that timing with sportscotland.

**George Foulkes:** I am slightly hesitant about asking questions on participation in sport, because mine is confined to an hour and a half every second Saturday at Tynecastle—

**Murdo Fraser:** That does not count.

**George Foulkes:**—and at Love Street at away matches, but there we are.

I agree with the Auditor General and Jim Hume that lots of strange questions arise from the report. There is no correlation between spending and participation or deprivation and participation. East Ayrshire and Midlothian are very similar ex-mining areas, yet Midlothian has high participation and East Ayrshire has low participation. According to exhibit 12, Scotland has quite high participation, but Portugal is down at the bottom, although it is doing a hell of a lot better at football than any of the United Kingdom countries.

I will keep off the subject of participation and ask a question about the Commonwealth games, on which Murdo Fraser commented. With respect, I say that we do not have to look at the Olympic games alone; we have had two Commonwealth games in Scotland, and I remember both of them, because I have been around for a long time. The more recent games got into terrible financial trouble, and the late, unlamented Robert Maxwell supposedly rescued them. I wonder whether any of the books from those games are still around for the Auditor General and sportscotland to examine, see what went wrong and ensure that it does not happen again.

**The Convener:** I would not inflict an investigation into Robert Maxwell on anyone.

**Mr Black:** Fortunately, or unfortunately, he is no longer available for interview. Such an inquiry would be too complicated and difficult for us to do, and I am not sure that the benefits would justify the effort. The serious point is that enough evidence is available on the experience of planning not only the London Olympics but events such as the Sydney games that it is clear what the half dozen major risks are. We should encourage people to concentrate on those in their planning.

**George Foulkes:** Are the people who were involved in the Commonwealth games still around? Was Peter Heatly one of them or was he



involved in 1970? If we look back, we might find some people who were involved in planning the more recent games rather than the 1970 ones.

11:15

**The Convener:** There are separate issues. Others are charged with drawing on past experience for planning purposes, and it would be helpful to draw to their attention the people to whom you referred. From an audit perspective, there is probably no great value in doing that, but those who are currently involved in the Glasgow experience might want to discuss it with those people so, if you have contacts, we could use them.

**Sandra White:** I will not comment on Robert Maxwell—my experience is political, not sporting—but I will comment on the differences between different areas, particularly in Glasgow. I am disappointed that we spend £X and there is no participation. There has been no audit of deprivation, but should there be an audit of sporting facilities and the choices that are offered in areas where there is less take-up? Irene Coll mentioned women's participation in sport. It might be worth while for someone—perhaps not Audit Scotland—to compare what is offered in the Western Isles and Glasgow or West Dunbartonshire, where the bulk of money is spent on sport but nobody seems to participate in it. We should examine that to find out whether the available choices are what people want.

I am glad that Mr Black said that there is a great deal of difference between the Olympic games in London and the Commonwealth games in Glasgow, where 70 per cent of the infrastructure is in place. I accept the report, which is excellent. We should monitor where the money goes, but it is not all doom and gloom. Unfortunately, that is what has been picked up, because the analysis is based on the London Olympic experience, which has been bad for taxpayers and bodies that are not getting lottery funding because it has been taken away for the Olympics. We should not concentrate too much on the doom and gloom aspect of the Olympics. I am glad that Mr Black raised the point that the Commonwealth games experience is different: a lot of infrastructure is in place—70 per cent, as he admitted; the Government and Steven Purcell, the leader of Glasgow City Council, have stated that a legacy will be left; and we are considering the construction industry's need for skills and apprenticeships.

I welcome the report and take on board the six points that Audit Scotland makes on the Commonwealth games. The Scottish Government should put in place an action plan, as recommended in paragraph 50, because we

should audit exactly what goes on. We should tell people that the games are a golden opportunity and we should not portray them so gloomily. I do not want to use the word scaremongering, but some comments have been pretty scaremongering. The fact that the analysis has been based on the London Olympics bid should be mentioned in anything that comes out of the audit, the committee or anywhere else. It has been based not on potential risks that Audit Scotland perceives for the Commonwealth games but on actual risks in the London Olympic games.

Mr Black mentioned that Audit Scotland will monitor the situation and report to the committee. Is that correct? Will there be reports every six months, every year or what?

**The Convener:** I suggest that Willie Coffey ask his questions now and Mr Black can answer both. After that, I intend to draw the item to a conclusion, because we are beginning to run late.

**Willie Coffey:** I am proud to be able to say that I ran a couple of marathons in my time, achieving a best time of three and a half hours. However, that was a considerable time ago.

I will ask Mr Black for his views on the problem that we appear to have in the connection between national and local sporting objectives. Exhibit 10 on page 22 of the report shows us a range of targets, most of which were unmet. One stands out as fairly spectacularly unmet: to provide two hours of physical education a week for young kids at school. Were the targets unrealistic—could they never have been achieved—or were they basically ignored? There is a huge disparity between the targets and what was achieved. Does Audit Scotland have any feel for whether local authorities signed up to them as doable?

**Mr Black:** I return to Sandra White's relevant and useful points and endorse what she said about provision in Glasgow. Audit Scotland's committed work programme includes an examination of leisure facilities and leisure management, but as that report will be about local government services it will go to the Accounts Commission and not to the committee. I am not sure whether anyone who is here from Audit Scotland can say to what extent that report will cover the issues that have been raised.

**Barbara Hurst:** The work has still to be scoped, but some messages from the overview report will be built into that work, as they provide a useful starting point for examining correlations between activity and spend, for example.

**Irene Coll:** I can answer Sandra White's question about which sports are popular and which are not. Sportscotland collects such information. The data show that the most popular sports are walking, cycling and football. In general,

the popularity of team sports is declining; people are participating more in individual sports and adventurous outdoor sports such as mountain biking. Programmes elsewhere suggest that street-game sports such as skating and skateboarding are becoming much more popular with young people. Sportscotland is considering the implications of the decline and growth in popularity of sports, so a body of evidence is available on that.

Questions and responses have fully covered the variation in spend, but we are also dealing with the historical position on expenditure. Each area's number and quality of sports facilities has differed. In considering expenditure, we must think of the wider context of the existing facilities and the upgrading and maintenance that they need, which could skew the interpretation of some figures.

**Mr Black:** On the quality of financial planning and whether there is a risk of being excessively pessimistic about how everything will turn out, I agree absolutely that we must not send out a message that we think that things are going wrong. I preface all my remarks by saying that it is important that we go into the Commonwealth games with our eyes open, but that that does not mean for a moment that the risks will become a reality.

I remind the committee that the Finance Committee considered in detail the financial memorandum that accompanied the Glasgow Commonwealth Games Bill and produced a positive report in January, which we have read carefully, as members can imagine. It says:

"The Committee found the provision of this full financial context helpful, and sought to examine some of the assumptions and unpredictability relating to these figures. The Committee acknowledges the significant level of scrutiny that the estimates have been subject to so far. It also acknowledges the apparently prudent approach taken to income and expenditure assumptions, and the governance arrangements intended to ensure robust management of delivery."

That gives us some assurance that we are starting from a good firm base.

Mr Coffey asked whether the national targets are realistic. The setting of targets is a matter of Government policy, but I am sure that the Audit Scotland team can help with a description of the targets.

**Irene Coll:** The targets in exhibit 10 are from sport 21, which was the national strategy for sport from 2003 to 2007. They were developed in consultation with the sector—with councils and sports governing bodies. The targets were not imposed on the sector; they were developed through an extensive consultation process. The sector says that some of the targets were aspirational and that it wanted them to be fairly

challenging. Whether the target of two hours of PE is reasonable has been questioned. In our report, we compared performance with England, which also has a target of two hours of PE. Performance in England is substantially different from that in Scotland.

**The Convener:** Thank you. I conclude the discussion and thank everyone for their participation.

## First ScotRail Passenger Rail Franchise

11:25

**The Convener:** The next item is the First ScotRail passenger rail franchise. We have a report from Audit Scotland on the project brief, which was revised in April. I invite the Auditor General to brief the committee.

**Mr Black:** I will be brief on this. As the committee will recall, Audit Scotland is currently undertaking a performance audit study on my behalf, assessing the performance of the First ScotRail franchise and Transport Scotland's management of that franchise. The franchise was established as a seven-year term with the option to extend the contract for a further three years. The Scottish ministers approved the franchise extension on 2 April, extending it to November 2014.

Transport Scotland did not notify Audit Scotland of the intention to award the extension for the franchise. It has told me that the reason for that was concerns about commercial sensitivities and confidentiality. In view of the committee's interest in the topic, I am bringing to it a revised project brief for the study. An objective that has been added to the study is to review the process by which the franchise extension was awarded.

The study has four key objectives. The first is to review the context in which rail passenger services in Scotland operate. The second is to evaluate whether Transport Scotland is managing the First ScotRail franchise effectively. The third is to review the process for awarding the franchise extension. The fourth is to assess First ScotRail's performance against the terms of the franchise agreement.

The study will review the awarding of the franchise extension, including the timing of the extension award, whether there were clear specifications and requirements, and, if so, whether they were met. The study will also examine the amendments that were made to the franchise by the extension agreement and how those were informed.

In addition to reviewing the relevant franchise documents and processes, we will continue the engagement that we have had for some time on the topic with Transport Scotland and First ScotRail. The study team will conduct interviews with representatives from passenger groups and interview the Scottish Trades Union Congress.

We expect the report to be published in late autumn but, as always, the timetable is indicative and depends on how the study goes. Along with

my colleagues from Audit Scotland, I am happy to answer any questions that the committee may have.

**George Foulkes:** The report and revised project brief are very helpful. I raised the matter informally at the end of our previous meeting because I was concerned. I am even more concerned now, although I am not criticising First ScotRail in any way for what happened. I find it astonishing that the franchise extension was announced during the recess and that there was no consultation with Audit Scotland. I find it unbelievable that the reason that has been given for that is commercial sensitivities and confidentiality. Frankly, that is an insult to the staff of Audit Scotland. It is outrageous and totally unacceptable that Transport Scotland should suggest that it cannot discuss such matters with Audit Scotland because of confidentiality.

Mr Black and his excellent staff are doing really good work examining the timing and the clear specifications and requirements after the event. Surely it would have been much better for Audit Scotland to consider the specifications and requirements before the extension was announced.

I recently saw an advertisement for service quality inspection regime inspectors, who are carrying out an assessment of the performance of First ScotRail. I wonder whether they were asked for their views before the extension was awarded. It may be that the extension would have been agreed in the end and that, after examining the specifications and requirements in the report, Audit Scotland would have recommended that, but that is not how it happened. Mr Black, would you have preferred to carry out the review to inform Transport Scotland before the event rather than after the event?

11:30

**Mr Black:** I find it difficult to answer that question because we have not yet done the analysis. It is possible that the analysis will confirm that the timing and procedure that Transport Scotland adopted were appropriate, for reasons that might become clear. Unfortunately, I do not yet have the information to answer those questions. I hope that, in the course of the study, we will be able to provide an objective and reasonably comprehensive assessment of what has happened.

**George Foulkes:** Surely you must agree that it would have been better if you had been consulted before. Do you not find that a bit of an insult to you and your staff?

**Mr Black:** There are times when audited bodies, at a senior level, feel it appropriate to keep me in

touch with developments on a private and confidential basis. That might have been appropriate in this instance, but I have to recognise that those involved in this instance had reasons for deciding that the matter was too sensitive to share with me on a personal basis.

**George Foulkes:** You are more likely to get an award for diplomacy than I am.

**The Convener:** Yes, I think we all recognised that a long time ago, George.

**Stuart McMillan:** In paragraph 22 of the brief, you say that the new study will not assess the awarding of the 2004 franchise as it was awarded before the Railways Act 2005. Would it be feasible to have a look at what happened at that time, as that would allow a comparison to be made between how the initial franchise was awarded and how the extension of the franchise was awarded? Do you agree that there might be some information there that could be used in the new study?

**Mr Black:** That is a matter on which I would need to take the advice of the team that is doing the work. Our starting point is that I do not have a formal remit in relation to things that happened before the responsibilities for transport were devolved to Scotland, so we have to be a bit circumspect about the extent to which we commit to going back before that point, but I am sure that if it emerged that it would be helpful to the study team to go back into an earlier period, people would be as co-operative as they could be in giving us access to that information. I would, however, prefer not to build it into a formal part of the study brief because it relates to a period in relation to which I have no powers.

**Stuart McMillan:** But you would not rule it out if it proved to be necessary?

**Mr Black:** No.

**Willie Coffey:** Where did the direction to include an examination of the contract extension review process come from? It is important to understand what happened, but will the main emphasis of your report be on the performance of the service as a whole, rather than on the processes that led us there? There is a danger that we could get caught up in the process, rather than concentrate on the outcomes and results.

**Mark MacPherson:** Obviously, within the scope of the study, we will look at performance and outcomes. I do not mean to be short with you, but that is our intention.

Your first question was about the extension.

**Willie Coffey:** Yes. How did it come about that your review includes an examination of the contract extension?

**Mark MacPherson:** It was always expected that whatever we did as part of this work might usefully inform any consideration of an extension, which was always an option, or the awarding of a new contract when the term of the original one was up. There was going to be consideration of the matter, but we have now agreed to look explicitly at the process that was involved in the extension.

**Jim Hume:** I would like to echo the concerns that Lord Foulkes expressed. Not notifying the study team is not just ignoring Audit Scotland, it is ignoring the Audit Committee, where we all spend our good time. Have organisations such as Transport Scotland ignored Audit Scotland and the Audit Committee before?

**Mr Black:** I cannot recall specific circumstances off the top of my head. I am sorry that I cannot help the committee in that regard.

It is worth making the point that the senior people in Transport Scotland were sensitive to the fact that this was a commercial contract and that the announcement of the award could—and, indeed, did—affect the share price of the company very quickly. Even if people had been willing to share the information with me on a private and confidential basis, it might have been problematical for the information to be shared more widely because of the impact that might have had, prematurely, on the share price. People were extremely concerned about that.

**Jim Hume:** The point of the Audit Committee and Audit Scotland is to ensure that public money is being spent properly. The issue that we are discussing concerns one of the largest budgetary items around. I share the concerns that have been expressed: that we were ignored and that, in effect, your confidentiality was not trusted.

**The Convener:** We await Audit Scotland's report, which is due later this year, with interest.

I thank the Audit Scotland team for their contribution.

We will now move into private session, to deal with agenda item 5.

11:36

*Meeting continued in private until 12:37.*

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