PUBLIC AUDIT COMMITTEE

Wednesday 3 June 2009

Session 3

£5.00

Produced and published in Scotland on behalf of the Scottish Parliamentary Corporate Body by RR Donnelley.

CONTENTS

Wednesday 3 June 2009

PUBLIC AUDIT COMMITTEE
11th Meeting 2009, Session 3

CONVENER

*Hugh Henry (Paisley South) (Lab)

DEPUTY CONVENER

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

COMMITTEE MEMBERS

*Willie Coffey (Kilmarnock and Loudoun) (SNP)
*Cathie Craigie (Cumbernauld and Kilsyth) (Lab)
*George Foulkes (Lothians) (Lab)
*Anne McLaughlin (Glasgow) (SNP)
*Nicol Stephen (Aberdeen South) (LD)
*Andrew Welsh (Angus) (SNP)

COMMITTEE SUBSTITUTES

Derek Brownlee (South of Scotland) (Con)
Linda Fabiani (Central Scotland) (SNP)
James Kelly (Glasgow Rutherglen) (Lab)
John Farquhar Munro (Ross, Skye and Inverness West) (LD)

*attended

THE FOLLOWING ALSO ATTENDED:

Mr Robert Black (Auditor General for Scotland)
Mark MacPherson (Audit Scotland)

CLERK TO THE COMMITTEE

Tracey White

SENIOR ASSISTANT CLERK

Joanna Hardy

ASSISTANT CLERK

Jason Nairn

LOCATION

Committee Room 4

Scottish Parliament

Public Audit Committee

Wednesday 3 June 2009

[THE CONVENER *opened the meeting at 10:01*]

Decision on Taking Business in Private

The Convener (Hugh Henry): Good morning and welcome to the 11th committee of the Public Audit Committee in 2009. I ask everyone to ensure that all electronic devices are switched off. I have received apologies from Murdo Fraser, who will be late in joining the committee.

Under the first item on our agenda, I ask members to agree to take items 4, 5 and 6 in private.

Members *indicated agreement*.

Section 22 Report

"The 2007/08 Audit of Stow College"

10:02

The Convener: Item 2 is consideration of a section 22 report on the 2007-08 accounts of Stow College. I ask the Auditor General to give us a briefing.

Mr Robert Black (Auditor General for Scotland): Good morning, convener. This is a report under section 22 of the Public Finance and Accountability (Scotland) Act 2000 on the 2007-08 accounts of Stow College. Although the college's 2007-08 accounts were not qualified, the notes to the accounts disclose a contingent liability. That means that there is a liability that might arise, depending on the outcome of certain events in the future. That could result in the Scottish Further and Higher Education Funding Council clawing back funding from the college, and the amount could be significant.

The contingent liability was identified as a result of the findings of a review that was commissioned by the funding council. That review was undertaken by the funding council's internal auditors and concluded that two programmes for which the college had claimed funding did not meet the teaching funding eligibility rules. One of the programmes related to Chinese language and cultural studies and was being delivered by the Glasgow Chinese School, which is a voluntary organisation that made use of the college's classrooms at weekends. The other programme related to construction training and was being delivered by Sibbald Ltd, a private company. In both cases, the review found that there was insufficient resource input from the college in terms of course programme development, management and delivery. In the case of the Chinese school, the college did not have systematic monitoring of the arrangements that were in place. Both those requirements—a significant input from the college and monitoring arrangements—are basic requirements of the funding council's teaching funding.

When a funding claim is deemed not to have met the eligibility rules, the funding council must consider what action to take, which could include clawing funding back. In the case of Stow College, we understand that, although the funding council has sought a clawback of funding—the amount could be substantial—the college does not agree with the findings of the review and discussions are continuing between the two organisations. For that reason, the final value of the funds that are to be clawed back has not yet been determined.

The issue has not yet been resolved, so the possibility remains of the funding council seeking a clawback of significant amounts of funding. If that happens, the college could face significant financial pressure. However, until the details are resolved, the precise impact on the college will not be known.

As ever, my colleagues and I will do our best to answer members' questions. However, as I am sure members will appreciate, this is a report on the accounts, not a full, detailed Audit Scotland investigation, and we are relying on the work that has been undertaken by the funding council's internal auditors.

The Convener: Thank you for those remarks.

Stow College received a significant amount of money from the funding council for construction industry training and then effectively subcontracted the work to Sibbald, paying it substantially less than it had received. Then, almost like a broker, Stow College kept what I gather was quite a significant surplus. Is that essentially what happened?

Mr Black: The circumstances are unusual. Some years ago, Stow College inherited from West Lothian College the arrangement with Sibbald for training provision. However, at that stage, there was no contract in place, and the funding council is concerned that no contract has subsequently been put in place.

That said, the funding for Stow College was claimed under the formula for distributing money from the funding council. We do not have detailed access to the precise numbers, because the funding council and the college are still discussing the matter. The concern is that the funding council believes that the college's contribution to the provision of training was minimal and therefore it was in breach of the basic rules for the granting of funding for such courses. The other concern is that the amount of money involved represents a significant part of the college's income, which is why I felt it appropriate to make a section 22 report.

The Convener: Do we—or you—know whether Stow College does the same thing with other significant income streams, and are you in a position to say whether the practice is common to all Scotland's colleges?

Mr Black: We do not know the extent to which Stow College might or might not have applied a similar arrangement to other funding streams. However, I can say that the funding council instructed its internal auditor to examine five projects, and the two projects covered in my report gave the greatest concern.

On your second question, any similar arrangement would clearly be in breach of the basic mandatory rules that govern the funding council's allocation of funds. However, I cannot give an absolute guarantee to the committee that it has not occurred elsewhere. In any case, I imagine that the funding council is better placed to answer such questions.

Andrew Welsh (Angus) (SNP): Why were written contracts not introduced until July 2007? Given that that represents a four-year gap for the construction industry training and a seven-year gap for the courses at the Glasgow Chinese School, the college's approach to two very important activities seems very slipshod.

Mr Black: As I said, we have not conducted a full audit investigation. As our report is based on the college's audited accounts, your question would be better addressed to the funding council and the college itself.

The Convener: Can you confirm that Stow College decided to opt out of the planned merger of colleges in Glasgow, which was proposed to create improved service delivery?

Mr Black: That is correct. Stow College was originally one of the partners in the plans for the merger, but it withdrew from that partnership comparatively recently.

Andrew Welsh: From reading the section 22 report, it seems that the college did not monitor the situation properly. A third party was delivering Chinese courses, which are very important—I declare an interest in the subject. If that situation was not monitored properly, is it a question of banging heads together to bring about a proper monitoring situation? Does the SFC have powers to do that? The college must see that the way forward is to put the monitoring on a proper footing.

Mr Black: The implication in your question is correct: arrangements for proper monitoring should be in place. The funding council has taken the initiative to try to rectify the shortcomings in the situation and, as I said, the matter is the subject of continuing discussions between the college and the funding council.

Anne McLaughlin (Glasgow) (SNP): I understand that five programmes were examined by the funding council.

Mr Black: Yes.

Anne McLaughlin: Two programmes are in dispute, which means that 40 per cent of the programmes that were examined have thrown up problems. Is it possible that such problems are more widespread in Stow College?

Mr Black: I am not sure that the inference of 40 per cent is correct. Forgive me if I misled the committee: what happened was that the funding council asked the internal auditors to examine five specific programmes, and as a result of the internal auditors' review, findings of sufficient concern were produced in relation to two programmes—the arrangement with Sibbald Ltd and the arrangement with the Glasgow Chinese School—to lead me to produce the section 22 report.

Anne McLaughlin: Did the funding council have existing concerns about the five programmes that it asked the auditors to examine, or did it just pick five at random?

Mr Black: There are detailed comments about the other programmes in the internal auditor's report, but they are not as significant as the comments on the two projects that we have identified in our report.

George Foulkes (Lothians) (Lab): What is the Scottish funding council's role in monitoring such issues?

Mr Black: The Scottish funding council has a central role. It is the funder of the colleges, as a result of which it has a duty to allocate funds to all 39 colleges in Scotland. It has clear allocation criteria, which are based on a formula plus conditions. It has a duty to oversee the standards of governance in the colleges, and a general duty to satisfy itself about their level of performance. The funding council is the main organisation with responsibility for overseeing such matters and taking appropriate action.

George Foulkes: Should the SFC have picked up the problems earlier?

Mr Black: I am not in a position to answer that. The point is that the SFC commissioned an internal audit report when the possibility of problems at the college came to its attention. It would be difficult for the SFC to find out about every case of a college making submissions that do not comply fully with the funding requirements. It has found issues in relation to the situation at Stow College that gave it cause for concern, and it has taken appropriate action by immediately commissioning a full internal audit review.

George Foulkes: You referred to the situation coming to the SFC's attention. Does the SFC not have inspectors who go around the colleges to keep an eye on such things?

10:15

Mr Black: It has what were once called the feds, who interact closely with the colleges to help them achieve sound financial management. Her Majesty's Inspectorate of Education also has a role in inspecting the quality of the courses that are delivered in colleges.

George Foulkes: Are you aware of the—

Mr Black: Excuse me, but I may have misled the committee. Mark MacPherson may be able to help. Was that an accurate answer?

Mark MacPherson (Audit Scotland): I was just going to add that that the funding council requires all colleges to submit student unit of measurement—SUM—returns each year to confirm the number of students who have participated in the various programmes that they offer. Those are generally subject to review by each college's internal audit team. However, given the number of students that most colleges have, a sample-based approach is taken. It is possible that, even though the internal auditor conducted a check on some programmes, they did not check all the programmes that were picked up in this internal review. The funding council uses additional methodologies to try to gain assurance about participation in individual colleges.

George Foulkes: What about the members of the college's board of management? Are you aware of the composition of the board and whether there are people on it with accounting or similar qualifications?

Mr Black: There are two issues. One relates to the way in which board members are appointed, which has been the subject of previous interest on the part of the Public Audit Committee. It is an issue to which we will return when we present to you, in a few months' time, our review of how boards work in Scotland. The second issue relates to the way in which the boards operate. We can assure you that, in Stow College and generally, contracts are let by the executive team and not by the board members. In the case of Stow College, the senior person in Sibbald is on the board and the internal auditor has drawn attention to that. However, the internal auditor concluded that they had no concerns about the operation of governance in Stow College because the interests of that person were properly declared and recorded.

Mark MacPherson: The next paper on the committee's agenda is an update on the financial position of colleges. As part of our work on that, we asked auditors to give us some assurance that there were people with appropriate financial expertise in place. The response that we received was that all colleges had someone on the board who had appropriate financial expertise.

George Foulkes: Mr Black said that the contracts are awarded by the executive team and not by the board. Does the executive team have to report to the board on those contracts—on their terms, progress and success or otherwise?

Mr Black: That should happen. We do not have the full information that would provide you with unqualified assurance on that. Nevertheless, one might reasonably expect the board to have a role in monitoring the performance of the contracts that are run by the college.

The Convener: As the Auditor General said, we previously took an interest in the issue of boards. That resulted in some fairly intemperate letters from college principals, complaining about the committee even asking questions about the process. Notwithstanding what Mr Black has said, Andrew Welsh has pointed out that one programme ran without contract for four years and that another ran for seven years without contract. The construction industry training contract amounted to nearly £1 million per annum—is that correct?

Mr Black: Yes.

Mark MacPherson: That was in the most recent year. In previous years, it was worth a lot less than that. That may have something to do with the contract arrangements.

The Convener: Okay. The contract rose to almost £1 million. I accept what has been said about there being no impropriety in relation to the board member who is from the company in question in the award of the contract, but if there are cosy relationships and executives who award contracts that are not subject to competitive tender, it will be easier for a contract to be awarded to a known person who sits on the board. I question whether contracts of such magnitude should be awarded in that way and in particular whether that should have happened when someone from the construction company in question sits on the college board. The individual no doubt gives his valuable time and expertise, which are undoubtedly welcome, but we can see how suspicions arise when such companies end up as beneficiaries of contracts that have been awarded without competition. I think that the matter needs to be considered.

Mr Black: I remind the committee that part of the concern in this case is that there were no formal contracts. The concern is that there are arrangements that represent more than 30 per cent of the weighted SUM returns claimed by the college and that the lack of formal contracts setting out each party's rights and duties means that the arrangements do not measure up to the standards of governance that one would expect. Although the auditor has no concerns about the corporate governance arrangements, the position of the gentleman concerned would be safeguarded if the contracts were properly tendered and awarded and robustly monitored.

Andrew Welsh: I would like to provide a little bit of perspective. We are concentrating on a particular aspect of a particular college. Back in 1999, the whole system—with, I think, the honourable exception of Angus College—was in considerable financial disarray, to put things mildly. That the situation has been turned around is a compliment to Audit Scotland. Five of the 39 colleges are in deficit, but all five have accumulated surpluses to cover those deficits. At least we can now concentrate on one college; in the past, there was a problem with the whole system.

The Convener: We will consider the broader picture under the next agenda item.

Willie Coffey (Kilmarnock and Loudoun) (SNP): I am interested in why the college's internal audit did not pick up the problem. Is it being suggested that it was picked up, but that there is a fundamental disagreement between the Auditor General's findings and the college's opinion? Paragraph 10 of the Auditor General's report says that the college sought legal advice

"and is of the opinion that the college has taken a fair and reasonable approach".

It is interesting that there can be such a dispute about a matter that should be crystal clear. Can a wee bit more light be shed on that?

Mr Black: I apologise if I am not explaining things as clearly as I should. The discussion is between the funding council and the college. My role is simply to provide a short report on the basis of the audited accounts. An investigation into the five contracts was commissioned by the funding council and led by its internal auditors. The college does not accept the funding council's findings, which are based on its internal auditors' report. That is still a matter of discussion. I am sorry if I have given the impression that the college is in dispute with my views and those of Audit Scotland. The issue is between the funding council and the college.

Andrew Welsh: Who will resolve that dispute? What mechanism will be involved? Will the dispute be resolved by mutual agreement?

Mr Black: The funding council and the college are having on-going discussions. I strongly encourage the committee to await the outcome of those discussions. As I said earlier, one of the main reasons why I produced my report was the distinct possibility that the funding council will consider clawing back significant funding and that that will have a significant impact on the college's finances.

The Convener: Thank you very much for that, Mr Black. We will return to the matter later in the agenda.

"Scotland's colleges—financial position 2007/08"

10:25

The Convener: We move to item 3. I invite the Auditor General to brief us on the wider issue of the financial position of Scotland's colleges in 2007-08.

Mr Black: This is a report on the finances of the college sector for the financial year 2007-08. College accounts close on 31 July each year, so the information is rather out of date relative to where we are now, in June of the following year. The report focuses on the overall financial position and provides an update on the key issues that were identified in the overview report on the further education sector, which I presented to the committee last year.

I do not think that it is appropriate to ask Audit Scotland to produce an annual overview report on the college sector, as I am not sure that that would be a good use of our resources. Nevertheless, I was happy to agree that Audit Scotland would provide a brief update on the high-level financial position, which continues to change. The content of the report is drawn mainly from audit reports and other information provided by auditors on each of the 39 incorporated colleges. We have also used information that is held by the Scottish funding council and, in a few cases, information that was provided by individual colleges.

When I presented last year's overview report, I was able to say that the sector had shown a significant improvement in its overall financial position. The overall surplus held by the sector has increased again this year. There has been a slight reduction—of one college—in the number of colleges reporting operating surpluses, but that is not significant relative to the overall picture.

Of the 39 incorporated colleges, 34 reported operating surpluses in their accounts for 2007-08. Although that is a slight decrease from last year's number, it compares very favourably with the position in the years prior to 2006-07. Mr Welsh has alluded to some of the problems that occurred in the sector in earlier years. The broad direction of travel within the sector is very positive. The overall surplus of colleges' income and expenditure reserves was £124 million at 30 July 2008, compared with £99 million in the previous year. It is worth noting, however, that just five colleges accounted for around 60 per cent of that surplus.

Five colleges reported deficits. Our report outlines those deficits and gives a brief description of the background to them. The colleges were Barony College, Cardonald College, Dundee College, Edinburgh's Telford College and Elmwood College.

Exhibit 1, at the back of the report, shows that the level of deficit compared to overall income varies among colleges, from more than 8 per cent at Cardonald College to 0.25 per cent at Edinburgh's Telford College. It also shows that, at all colleges, there were accumulated surpluses that were sufficient to cover the deficits. That is an important point to bear in mind.

The committee has already considered the section 22 report on Stow College. I do not propose to say anything more about that.

The committee may also recall two issues that resulted in section 22 reports last year. The first related to the accounts of Kilmarnock College, where the auditor could not secure sufficient assurance to provide an unqualified opinion on the accounts. The 2007-08 accounts of Kilmarnock College were also subject to a disclaimer on the audit opinion for the same reason. The investigation has still not concluded, so I am prevented—as I was last year—from commenting on the issue any further.

The other issue that resulted in section 22 reports for a number of colleges last year was the accounting for pensions by colleges. Four college accounts were qualified in 2007-08 as a result of the accounting treatment for pensions. I am delighted to say that Russell Frith, our director of audit strategy, is with me today to answer any questions that the committee may have on that issue. It is fair to say that he is one of a small, select band of people in Scotland who can explain the issue and what it means for the accounts of colleges. I am a great believer in delegation wherever possible, and never more so than in this instance.

10:30

In last year's overview, I highlighted a number of challenges and cost pressures for colleges. Members will see from the update report that most of those remain. A circular from the funding council last December said that up to 26 of the colleges forecast surpluses of less than 1 per cent in 2010-11. Colleges are due to submit their latest financial forecasts by the end of June, which will provide an update on the picture. Unfortunately, that information was not available in time to be included in the update for the committee. It is worth mentioning that the risk of colleges losing their charitable status, which was identified last year, has now been resolved. As I am sure the committee is aware, the Scottish Government has since introduced legislation to protect colleges' charitable status.

I am pleased to say that the auditors reported that the governance and management arrangements in colleges were generally sound. As Mark MacPherson said, I reported last year that some college boards of management did not have members with recent relevant financial experience. I am pleased to report that the auditors have confirmed that all college boards now have members with relevant financial experience.

Overall, the position remains broadly similar to that which I reported last year. Like many other organisations in the Scottish public sector, colleges face real challenges relating to the funding settlement and the impact of the economic downturn. Auditors will continue to monitor the situation in future.

The Convener: I have a question about Kilmarnock College, to which you referred. Yet again, there is a disclaimer on the audit opinion on the college. You have indicated that an investigation is on-going. Some considerable time has elapsed since a completed and acceptable audit process has been carried out. Is the on-going investigation the police one, or some other one? What are the reasons for the delay?

Mr Black: It is a sufficient condition for us not to take the matter any further that there is a police investigation going on. I imagine that our information on the wider context is pretty limited. I ask Mark MacPherson whether we can help at all.

Mark MacPherson: No. You are absolutely right about our information. I have been in regular contact with the board chair in the period between last year and this year, but he has not been able to say much about the situation and I have not been able to ask or say too much about it, either.

The Convener: Other than the specific issue that is the subject of the on-going investigation, has the auditor picked up any other issues in relation to the accounts at Kilmarnock College?

Mark MacPherson: No. There are no significant issues, other than ones that we might expect with any audit.

George Foulkes: I am not clear why the inquiry is taking so long.

Mark MacPherson: I am afraid that I do not know, either.

George Foulkes: When did the police inquiry start?

Mark MacPherson: It started before we brought the report to the committee last year.

George Foulkes: So it has been going for more than a year now.

Mark MacPherson: Yes.

The Convener: We have established that it is a police inquiry. We will not go into a discussion on that specific issue.

Willie Coffey: I emphasise that the qualification on the accounts is not new—it is the same qualification that has been continued from last year, for reasons that the Auditor General and the convener have explained. We received advice previously that we should not engage in any further discussion of the issue until the police investigation concludes. I am absolutely certain that the college is hopeful that the investigation will conclude as soon as possible, which will enable the qualification to be removed from the accounts.

The Convener: Are there any other questions on college finances?

Andrew Welsh: Why did five colleges not have a detailed and up-to-date fixed asset register when their 2007-08 accounts were signed off? Is that matter being sorted?

Mark MacPherson: I cannot offer a detailed answer on that. The auditors have reported that situation in their reports to us. We expect all organisations to adhere to that standard. In some cases, the asset register might not have been fully up to date, so a review or an update would be needed, while in other cases the register might not have contained enough detail. We do not have the full details of why that happened. The auditors have recommended that the registers be updated. When we receive the reports later this year, we will find out whether that has happened.

George Foulkes: Edinburgh's Telford College had a small deficit, but exhibit 1 shows that it had an accumulated surplus of £33 million. Is that not a particularly high figure for a college with that size of turnover?

Mark MacPherson: It is high, but we understand that £26 million of that was from a gain from the disposal of the college's old estate and that the money is being fully reinvested in the new estate. Over time, that will erode the figure. It is an issue of estate development.

Willie Coffey: I recall that we discussed previously the colleges' plans for future investment and development and whether they had sufficient funds for that. Has there been any further examination of that issue, which was of interest to the committee?

Mr Black: We have not done any further work on that since our report last year. As I explained, we are not in a position to prepare a full and detailed performance audit overview on an annual basis.

The Convener: As there are no more questions, I thank the Auditor General for his contribution.

We will now move to agenda item 4, which we will consider in private.

10:36

Meeting continued in private until 12:20.

Members who would like a printed copy of the *Official Report* to be forwarded to them should give notice at the Document Supply Centre.

No proofs of the *Official Report* can be supplied. Members who want to suggest corrections for the archive edition should mark them clearly in the daily edition, and send it to the Official Report, Scottish Parliament, Edinburgh EH99 1SP. Suggested corrections in any other form cannot be accepted.

The deadline for corrections to this edition is:

Monday 15 June 2009

PRICES AND SUBSCRIPTION RATES

OFFICIAL REPORT daily editions

Single copies: £5.00
Meetings of the Parliament annual subscriptions: £350.00

The archive edition of the *Official Report* of meetings of the Parliament, written answers and public meetings of committees will be published on CD-ROM.

WRITTEN ANSWERS TO PARLIAMENTARY QUESTIONS weekly compilation

Single copies: £3.75
Annual subscriptions: £150.00

Standing orders will be accepted at Document Supply.

Published in Edinburgh by RR Donnelley and available from:

Blackwell's Bookshop

53 South Bridge
Edinburgh EH1 1YS
0131 622 8222

Blackwell's Bookshops:
243-244 High Holborn
London WC1 7DZ
Tel 020 7831 9501

All trade orders for Scottish Parliament documents should be placed through Blackwell's Edinburgh.

Blackwell's Scottish Parliament Documentation Helpline may be able to assist with additional information on publications of or about the Scottish Parliament, their availability and cost:

Telephone orders and inquiries
0131 622 8283 or
0131 622 8258

Fax orders
0131 557 8149

E-mail orders
business.edinburgh@blackwell.co.uk

Subscriptions & Standing Orders
business.edinburgh@blackwell.co.uk

Scottish Parliament

RNID Typetalk calls welcome on
18001 0131 348 5000
Textphone 0845 270 0152

sp.info@scottish.parliament.uk

All documents are available on the Scottish Parliament website at:

www.scottish.parliament.uk

Accredited Agents
(see Yellow Pages)

and through good booksellers

Printed in Scotland by RR Donnelley