PUBLIC AUDIT COMMITTEE

Wednesday 4 November 2009

Session 3

£5.00

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

CONTENTS

Wednesday 4 November 2009

PUBLIC AUDIT COMMITTEE
16th 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)
*Bill Kidd (Glasgow) SNP
*Anne McLaughlin (Glasgow) (SNP)
*Nicol Stephen (Aberdeen South) (LD)

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)
Angela Canning (Audit Scotland)
Dick Gill (Audit Scotland)
Mark MacPherson (Audit Scotland)

CLERK TO THE COMMITTEE

Tracey White

SENIOR ASSISTANT CLERK

Joanna Hardy

ASSISTANT CLERK

Jason Nairn

LOCATION

Committee Room 2

Scottish Parliament

Public Audit Committee

Wednesday 4 November 2009

[THE CONVENER *opened the meeting at 10:05*]

Decision on Taking Business in Private

The Convener (Hugh Henry): Good morning. I welcome members of the public and press and Audit Scotland staff to the 16th meeting of the Public Audit Committee in 2009. I remind everyone present that all electronic devices should be switched off so as not to interfere with the recording for the *Official Report*.

This morning, we have received apologies from George Foulkes. I welcome James Kelly, who is here as a substitute in his place. We have also received apologies from Cathie Craigie.

Does the committee agree to take in private items 6, 7 and 8?

Members *indicated agreement*.

Section 23 Report

"Review of Cairngorm funicular railway"

10:06

The Convener: Item 2 is consideration of a section 23 report entitled "Review of Cairngorm funicular railway". I ask the Auditor General to give us a briefing.

Mr Robert Black (Auditor General for Scotland): Good morning. My report on the Cairngorm funicular railway was published on 8 October and looks at the involvement of Highlands and Islands Enterprise—which, if members do not mind, I will call HIE from now on—with the funicular over the 17 years since the start of the project. It looks at the appraisal of the business case, the building of the funicular and HIE's role in trying to secure the benefits from it, including the decision last year to take over the operating company, which is called Cairngorm Mountain Ltd.

There has been a great deal of public interest in the funicular since it was first proposed. From the correspondence that I understand it has received, the committee will be aware of the continued interest in the subject. As the committee will appreciate, the report covers a long period. The initial stages of the funicular project took place before the post of Auditor General for Scotland or Audit Scotland existed. However, we have included a commentary on the earlier stages to provide as full a picture of events as possible.

The project's life cycle spans the systems of government that existed before and after devolution and the different administrative arrangements between HIE and its sponsor body. Also, HIE has changed its methods of operating, in particular the way in which it appraises major capital projects. Audit Scotland has tried to take account of those factors in preparing the report.

As the committee will recall, I had hoped that my report would review the plans for the new business model that HIE is developing for the funicular. I delayed publishing my report earlier this year to accommodate delays in HIE's work on that. However, as further delays were expected and would have prevented me from publishing until spring or summer next year, I thought that I should publish my findings to date. I have not included any assessment of the future business model. Audit Scotland will review HIE's work on that when it becomes available.

I would like to highlight to the committee three key areas of the report: first, the appraisal of the business case and the risks facing the project; secondly, the costs and benefits of the project; and lastly, the support that HIE has provided to the operator to protect the public investment that has been made so far and to keep the funicular open.

I turn first to the business case and risk assessment. The business case for the funicular was subject to appraisal by HIE's board, the then Scottish Office and the European Union in 1997. The appraisal and approval process met the expected standards and requirements that existed at the time. The National Audit Office examined the process in 1999 and found that the appraisal covered the expected examination of the economic, environmental and financial impact of the project that was required at the time. HIE was aware that the project faced risks such as the complexity of constructing the funicular and the need to meet strict environmental requirements, but thought that the funicular would bring economic benefits to the area. Ultimately, its decision to invest was a matter of judgment.

However, early in the project, there were a number of important changes that were likely to affect its viability. HIE did not review or adjust the business case before construction started in 1999 to take account of, for example, the declining number of skiers and the evidently weak financial position of the operating company. On page 17 of the report, exhibit 9 illustrates the downward trend in visitor numbers and in the financial performance of the operating company between 1997 and 1999.

Since the 1990s, there have been significant improvements in how projects are appraised and managed, and HIE has improved its procedures in line with that. It is perhaps worth noting that some of the findings on the funicular are similar to those that I presented to the committee in our review of major capital projects last year.

I turn now to the benefits of the funicular and its cost. HIE saw the funicular as a key development in the regeneration of the Strathspey area, and the business case identified a number of economic and other benefits to which the funicular was expected to contribute. Before I discuss that further, it is worth noting that assessing economic benefit is widely recognised as being hard. It is a challenging task because of the difficulty in attributing impacts or benefits to a single event.

In 2006, consultants reported that the funicular had delivered the expected employment and economic benefits. The consultants estimated that, across the Highland area, the employment impact in 2006 was 174.5 full-time equivalent jobs created or retained, compared with the expected 115.5 jobs created or retained when the funding was approved. In addition, the consultants found that there had been significant new investment in the Aviemore area and greater use of the area by tourists. In keeping with our usual approach, we did not independently review the consultant work. However, the final cost of the funicular was also much higher than expected. It cost £19.5 million to build, which was almost £5 million more than planned. HIE and the European Union funded that, with HIE contributing £16.9 million, which is 87 per cent of the total building cost.

Finally, I would like to say a little about the other support that HIE provided to the operator to help to secure its continued operation and to protect the public sector's investment.

In addition to the sums that I have just mentioned, HIE provided a further £2.5 million to the operator, as well as other support to develop the funicular and to keep it running. HIE bought the existing buildings from the operator and later reduced the rent to be paid by the operator for the use of the funicular. HIE also provided funding to improve the marketing and health and safety of the facility. In addition, Highland Council, the Bank of Scotland and the Cairngorm Mountain Trust provided funding of almost £4.7 million. That brings the total cost to date of building the funicular and supporting the operator to £26.75 million, of which £23 million was from the public purse.

HIE invested a great deal of money, time and effort in the project to try to ensure that it delivered the benefits that were anticipated in the business case. However, despite HIE's assistance, the operator struggled financially following the opening of the funicular. It made a loss of more than £262,000 in the year to April 2007.

In 2008, HIE took over the operator to protect the public sector investment and to keep the funicular running. HIE employed consultants to assist it to develop a new business model for the funicular, but the report was delayed until September of this year, and I understand that HIE expects to discuss options at its board meeting next month.

Although HIE hopes to find a new operator for the funicular, that might prove difficult in the current economic climate. It is important to state that, if HIE cannot establish a viable business model for the funicular, and it ceases to operate, HIE might have to reinstate the land, repay the EU's money and meet any other costs. I emphasise that we do not know at this stage whether that is likely, but the scenario carries those risks, so I feel obliged to mention it to the committee.

The committee will note that the report includes a number of recommendations for HIE, such as that it needs to consider rigorously and fully the risks and challenges that the funicular faces and to ensure that any prospective operators are fully aware of them. I am sure that HIE will take those recommendations on board in developing the new business model, which it is shortly to consider.

As ever, the Audit Scotland team, who are masters of the detail of the report, will help me to answer any of your questions.

10:15

The Convener: It would certainly be useful for any consideration that we might make if we had access to the future business model and your comments on it. What is the likely timescale for that?

Mr Black: To some extent, we are in the hands of HIE and its decision-making timetable. The latest indication is that it will consider its options in December. What happens after that is unclear. I have asked that the auditor continue to review that, which I can guarantee to the committee. I expect the audit for the current financial year of 2009-10 to include an audit review of HIE's business model as and when it becomes available, and I expect it to be mentioned at the conclusion of the audit of 2009-10 at the very latest. We cannot offer a guarantee if the committee wishes to have something sooner than that, because we are in the hands of HIE and its decision-making process, but I can certainly give an undertaking that the matter will be covered in the audit of the current financial year.

The Convener: Thank you. On page 7, in part 1 of the main report, you say:

"The appraisal and approval process for the funicular met requirements at the time."

Did you consider whether the decision was correct?

Mr Black: It was a policy decision for HIE and the Scottish Office to make. The Scottish Office, the EU and HIE took a policy decision to commit to the investment. It would not be appropriate or possible for us to revisit that.

James Kelly (Glasgow Rutherglen) (Lab): You have looked back over a long period of time. It is clear that, at the outset of the project, the risk assessments and monitoring were not as robust as they are now—Audit Scotland is now in place, which I am sure reassures people. One of the things that really concerns me, which has already been alluded to, is the amount of time that HIE has taken to consider its options. That is noted in the submission from the local conservation group. HIE commissioned the consultants in December 2008 to examine the business model, which is crucial in order to assess whether it is sustainable in the longer term. For some reason, the report was not available in March 2009. It became available in September 2009, but it will be December before the options are considered. Given that the project is crucial to the local area, I am concerned that it has taken a full year for HIE to commission the work and to start to consider the options.

The Convener: Do you want to comment on that?

Mr Black: I absolutely acknowledge Mr Kelly's point. As I said earlier, I would be surprised if HIE were not facing considerable challenges in getting a business plan together with private sector involvement, given that, as we note in the report, in the past financial year the draft accounts for the 11-month period ending March 2009 showed a loss of almost £43,000 before tax—that is from the unaudited accounts. There is still the problem of a loss-making facility against the background of no change in the overall business environment within which the funicular operates.

Willie Coffey (Kilmarnock and Loudoun) (SNP): Let us turn to the initial financial planning stages that are outlined in the Auditor General's report. The report says that all the correct practices at the time were followed. However, the comments on page 2 of the key messages report relating to contingency set-aside for the project show that, even in the early stages, the project was woefully short. Standard practice was to set aside 15 per cent of the contract value for contingencies, which would have given the project a £2 million set-aside. However, even in the early stages, only £645,000 was set aside and that figure fell to a paltry £7,600 contingency set-aside, so even in the early stages, sadly, alarm bells were ringing about the financial planning for the project. Was Mr Black involved at that stage or were his predecessors? The evidence shows clearly that there was something seriously wrong with the financial planning for the project.

Mr Black: We are not well placed to assist the committee on the detail of the factors that were taken into account in making the initial decision. It was a long time ago and we do not have all the information that was available. A contingency provision was made, and we know that it was significantly reduced when HIE received tenders that were higher than the estimated amounts. HIE drew back the contingency provision, which would have been a warning sign. I imagine that, at the time, HIE was focused on trying to contain the overall cost to the public purse to the cash limit that the then Secretary of State for Scotland had indicated would be the absolute limit.

Does Mark MacPherson want to add to that?

Mark MacPherson (Audit Scotland): HIE's internal audit team carried out some work subsequent to the construction of the funicular railway that identified that very issue. It said that the contingency level was too low for a project of that scale, especially when it was reduced to the figure of around £7,000, to which you referred.

Willie Coffey: I have another question. The committee has seen reports on other projects in respect of which the estimates for visitor numbers or whatever were inaccurate. The VisitScotland report, for example, showed that the estimates were hugely optimistic about the number of visiting skiers and that such optimism was not borne out. I wonder what kind of rigour is applied in making estimates for such projects. The more optimistic a project is in the early stages, the more viable the business plan appears to be. How do we challenge such assessments and estimates and get better at making them? Obviously, 10 years ago we were woefully wide of the mark again.

Mr Black: As we noted in the review of major capital projects and how they were managed last year, the world has moved on significantly in the years since devolution, and project appraisal and management are now significantly stronger than they were in the early days. However, that is not to say that no risks are associated with those processes. It is important that those who make the principal decisions on such matters prepare their analyses thoroughly, and that those analyses are subject to independent challenge and testing for their robustness before funds are committed. That goes without saying, but there can never be guarantees in such matters.

Willie Coffey: If that kind of rigour had been applied at the time, would the project still have been given the go-ahead, or is that inviting you to comment on something that you would rather not comment on?

Mr Black: I would prefer not to comment on that, if you do not mind.

Murdo Fraser (Mid Scotland and Fife) (Con): I thank Audit Scotland for its report, which is extremely useful and informative. It shines a light on a project that has disclosed some serious weaknesses, for which we should be grateful to Audit Scotland. I have several questions through which I will try to probe the facts behind the report.

First, I wish to ask about the business case. Exhibit 9 on page 17 shows visitor numbers. When the business case was approved in 1997, it was against a backdrop of eight or nine years of sharply falling skier numbers at Cairngorm, as far as I can tell. By 1997, the number of visitors seemed to be roughly half what it had been 10 years previously. Mr Black, you said that HIE did not review the project at that stage to consider the effects of the decline in skier numbers on the project. Do you regard that as a serious weakness on the part of HIE?

Mr Black: My short answer is that it was a weakness. It is reasonable to expect HIE to have revisited the business case at that point and to have recalibrated some of its calculations, taking into account the fact that the operator was struggling financially. With the operator struggling financially in that climate, it would have been reasonable for HIE to take full account of what that implied for the company as a future going concern. We do not have full access to the records from that time, but on the basis of the information that is available to us, it is our understanding that there was no reappraisal at that point.

Murdo Fraser: That is helpful.

Let me go on to a slightly different tack, with some questions about the cost to the public and the economic benefit of the project, which is covered in exhibit 11, on pages 21 and 22 of the report. I am not sure whether you have had access to the submissions that committee members have received from Ramblers Scotland and the Badenoch & Strathspey Conservation Group, but they question some of the assumptions behind Audit Scotland's report, which are in the Burns and Westbrook consultants' report, on which I think you base some of your findings.

On the cost to the public, paragraph 13 of the Audit Scotland report says:

"since 2001, the total cost is £26.75 million",

of which £23 million is public funding. However, as you say in paragraph 99, there was an additional cost to HIE from acquiring the operation, and,

"For reasons of commercial confidentiality",

it is not possible for you to disclose what that sum was. The committee has been here before. You will understand our frustration that we cannot get a complete picture of the expenditure of public funds where commercial confidentiality prevents such a disclosure. Do you accept that the additional costs will be higher than what is in your report? Do you also accept that there is a cost to Government of borrowing £23 million to fund the expenditure, which also requires to be accounted for?

Mr Black: I will ask Mark MacPherson to help us with this, but I re-emphasise one point to the committee first: we did not re-perform any of the calculations that were undertaken by the consultants. We say in our report that the costs and benefits were from the findings in the consultants' report. None of the numbers that are reflected in our report are our numbers. I ask Mark MacPherson to help with the background.

Mark MacPherson: It is worth clarifying that the outcome figure of £19.54 million that is given in exhibit 11, to which Mr Fraser refers, is the total construction cost. Elsewhere in the report, we highlight the other support that was given to the operator to assist it to make the business viable.

On the point about disclosure, the full amount, including the payment that was made by HIE to the bank, is included in the overall figure of £26.75 million; it is just that we cannot provide the breakdown of how that was paid for by HIE in buying the debt.

Murdo Fraser: It is helpful to get that clarity.

Let me also ask you about "Employment impact", which is covered at the foot of page 22. The final line of exhibit 11, at the bottom of that page, gives the net grant equivalent cost per job, according to the business case, as £11,000. According to calculations provided by Ramblers Scotland, if it is a simple matter of dividing the total cost of £23 million by the 174.5 jobs created, the average cost to the public per job is more than £131,000. I know that exhibit 11 has no outcome cost to the public purse to compare with the cost in the business case, but do you accept that the outcome cost is higher than the £11,000 in the business case?

10:30

Mark MacPherson: We cannot say with absolute certainty that the outcome figure is higher. It is clear that the figure of £11,000 was not calculated simply by dividing the original expected total cost of £14.8 million by the expected number of jobs—doing that would have produced a much higher figure. I understand that the cost-per-job calculation that HIE used took account of other factors, such as the type of financial assistance that was to be provided and comparative interest rates.

It is unfortunate that HIE has not calculated the outcome cost and no longer uses such a measure. We have been unable to secure the data that would allow us to perform a similar calculation. HIE used a spreadsheet to calculate the figure but we have no access to the detail of that and HIE no longer has it.

Mr Black: To support what Mark MacPherson said, I will say that I would have been far happier had we been able to access the original spreadsheet and look at the numbers, but time has moved on and the original calculations are no longer available. All that we had for the report was the figure that HIE supplied to us.

Murdo Fraser: We should pursue the issue with HIE, convener. The committee will discuss that later.

Mark MacPherson: You also referred to the cost of borrowing. We have no evidence to suggest that borrowing was undertaken specifically to fund the investment.

Nicol Stephen (Aberdeen South) (LD): The trading position of any ski operating company in Scotland is vulnerable and weather dependent. I am interested in the figures on pages 24 and 25, which go into detail about what is in the graph on page 17, to which Murdo Fraser referred. Paragraphs 92 to 94 and paragraphs on page 25 go into greater detail about the financial position.

I will ask about the company's trading position and its losses. Some figures from the early part of this decade are truly staggering. The losses were £1.875 million in the year to April 2002, £1.209 million in 2003 and £576,000 in 2004. Paragraph 95 says that in the middle of the decade, the position stabilised at

"a small loss of £36,000 in … 2005 and a small profit of £32,000 in … 2006."

However, a larger loss of £262,500 in 2006-07 seems to have triggered HIE's intervention.

Year after year of major losses in the early part of the decade triggered lots of action but no intervention—HIE did not bring the company into public ownership. Yet once things started to stabilise—as reflected in the graph on page 17 on the trading position and visitor numbers and as shown by the fact that in 2008, when the company was taken into HIE's ownership, it reported a profit of £173,000—HIE intervened.

Today, we are talking about the possibility, which I very much hope does not occur, of removal, reinstatement and repayment to the EU. Can we be given greater insight into the simple question of why now? Why did HIE intervene in 2008, when the position was levelling out for the first time? The poor trading position—the loss—in 2007 is attributed to a poor year for skiing visitors, rather than a new development that affected the funicular railway. I ask a simple question.

Mr Black: I invite Mark MacPherson to give a full and detailed answer. As context, I hope that the committee finds exhibit 9 helpful, because it demonstrates that CML's financial performance was such that it did not make profits in any year after about 1991. The trend after that up to the very recent past has been one of year-on-year failure to make a net profit.

I was asked whether it would have been appropriate for HIE to revisit some of the risks before it committed the funding. In paragraph 75 on page 18 of the report, we start the story by describing how

"CML was struggling financially. In 1997 and 1998, CML reported losses of £607,000 and £625,000 respectively".

That was a high percentage—between 33 and 48 per cent—of its annual turnover. The problem goes right the way back, to well before devolution. As Mr Stephen indicated, we attempt to give a résumé of what has happened subsequent to devolution. I invite Mark MacPherson to answer Mr Stephen's questions.

Mark MacPherson: It is important to recognise that HIE provided support, including financial and other support, throughout the period, which probably helped the position in the short term. The improvement in the overall position was not all of CML's making. Mr Stephen asked why HIE acted when it did. HIE was concerned that, given that it was not the only body that had an investment in the funicular and its operator, the operator's position would be threatened if it did not manage to turn matters around. For example, the bank had an on-going interest because of a loan that it had made to the operator; we understand that it may have wanted to pursue that. HIE decided that, in the circumstances, it needed to take further action to secure the future of the funicular and the public investment that had been made in the asset.

Nicol Stephen: When HIE took the asset into its ownership, was it aware that in the trading year concerned a profit was about to be made? Mr Black, did you say that that was the first profit that had been made ever, or the first that had been made in many years?

Mr Black: The first in many years.

Nicol Stephen: I think that you said that, after punitive losses in previous years, it was the first profit that had been made since 1991. The report states that the management accounts for an 11-month period in 2008-09 show a loss of £42,000. Do we have the full-year position, now that matters have moved on from March?

Mark MacPherson: CML has moved to match HIE's financial year, so that is now the end of the financial year. We will not know the overall yearly position until the end of the next financial year.

Nicol Stephen: Okay, but it would not be unreasonable to expect that the company's full-year position would be a loss of £40,000 to £50,000.

Mark MacPherson: It is difficult to say. We know, for example, that in the month that followed the end of the financial year there were a further 19,000 visitors, which might have had a positive impact on the figures. We cannot say that without seeing the financial statements for the period.

Nicol Stephen: I come back to the basic principle that the figures tend to support the suggestion that the situation has stabilised significantly compared with the early part of the decade, when multimillion-pound cumulative losses were racked up.

Mark MacPherson: It is difficult to say. We know that the increase in visitor numbers throughout the rest of the year—non-skiing visitors—has had a positive impact on the position, because those visitors generate income. However, the funicular is still very dependent on skiing visitors. If last year was a good year for skiing, that may have influenced the position. If the following year is a poor year for skiing, income could again take a significant dip. No one knows for certain what the weather will be.

Nicol Stephen: Is it fair to say that the figures in the graph in exhibit 9 indicate that skiing numbers have continued to decline, as Murdo Fraser highlighted, to 50,000 visitor days—if that is how the numbers are calculated—whereas, because of the funicular, the figure for non-skiing visitors has risen to more than 150,000 visitor days?

At Cairngorm, we now have a visitor attraction, if we want to look at it in that way, and 75 per cent of visitors are non-skiing. Only 25 per cent of the total is dependent on skiing, in broad terms. If the funicular element of the Cairngorm centre was removed, the skiing would clearly not be viable.

Mark MacPherson: There are other methods of uplift on the mountain, but the funicular takes passengers straight to the top of the slopes. If they ski down part of the mountain, they can then use other methods to return to the top from another point. However, the funicular is the primary uplift method for skiers. It has the greatest capacity on the site.

Nicol Stephen: Yes, but as Murdo Fraser said, the number of skiing visitors has halved since the funicular was introduced in the early part of the decade. I find it hard to believe that any alternative skiing proposition or company could have a remotely profitable and sound trading position at Cairngorm. The funicular is now heavily dependent on non-skiing visitors.

Mark MacPherson: Of course, it needs the skiing visitors as well. Without them, it would be in a far worse position. However, I cannot comment on whether there is a viable skiing opportunity there. That is one of the challenges that HIE faces in its overall consideration of what to do with the funicular.

Willie Coffey: That brings us nicely back to the business model, which we are eagerly awaiting but which is taking almost a year to deliver. Nicol Stephen's remarks probably give us a hint as to why it is taking so long. In my view, it cannot be based on skiing as the core business activity. Given the figures in the report, it seems clear that it will be based on the related business activity.

Is there any more information about why it is taking a year to put the business case together? I know that Mr Black felt compelled to publish his report before the business case was produced, and members have suggested that we are desperately keen to see it. Why is it taking so long?

Mr Black: We do not have access to that information. You would require to put that question to HIE.

The Convener: Can I take you back to a comment that was made in passing? If HIE decided to close down the operation and financial support was withdrawn, what would be the costs to the public purse through HIE and the European funding that you mentioned? If the decision was made to close it, what would be the associated costs?

Mr Black: I invite Mark MacPherson to help with that. I hope that you do not mind me saying this, convener, but we would not want to start any rumours about that, because we do not know whether it is a remote possibility or a significant risk.

Mark MacPherson: The major financial risk to the public purse is the cost of the reinstatement that would be required by the conditions under which the funding was approved. We mention that in paragraph 105 of the report, on page 25. HIE was at pains to stress to us that the £30 million to £50 million figure that is quoted in that paragraph is purely speculative. It has done no detailed validation work, and nor have we, on the likely cost of reinstatement. However, it is likely that there would be a high cost associated with that.

There would also be a requirement to repay the EU grant of £2.6 million to £2.7 million, and there might be other costs such as redundancy costs if the terms and conditions of employment required that.

The Convener: If previous experience is anything to go by, £30 million to £50 million could be a conservative estimate.

10:45

Mr Black: That highlights the difficulties of exit strategies from major projects, which one comes across from time to time in the public sector. This is a classic case of that problem. Once one is committed, it can often be difficult to get out at a reasonable cost. It might well be that we are now facing that risk, and it might well explain in part the care that HIE is taking in developing a business model for the future.

The Convener: HIE is in a difficult situation. There is no suggestion that the plug should be pulled but, if the worst came to the worst, huge costs would be associated with doing that, although we do not know exactly how much they would be. I presume that one thing that has been considered is how the lessons can be applied to other projects, as we have tried to do with other reports. I also presume that consideration has been given to where improvements can be made to this specific process. The future business model is critical if we are to come to any sensible conclusion about what should happen, so we are at a slight disadvantage in that we do not have access to it at present. However, we can consider that when we discuss the issue later.

As members have no further questions or comments for the Auditor General, I thank him and his team for that briefing. We will return to the issue later in our agenda.

Section 22 Report

"The 2008/09 audit of Registers of Scotland"

10:46

The Convener: Agenda item 3 is on the section 22 report "The 2008/09 audit of Registers of Scotland". I invite Mr Black to give us a briefing.

Mr Black: The report is intended to inform the committee about developments affecting the finances of Registers of Scotland. Because of the effects of the economic downturn, ROS made an operating deficit of about £11 million in 2008-09 and further, larger deficits are anticipated in the future. ROS is responsible for compiling and maintaining 16 public registers relating to property and other legal documents. It gets its income from customers by charging for registrations and for providing information from the registers. Those customers include the general public and professional users, particularly solicitors.

ROS has operated at a trading profit since 1996 and, until 2008-09, it generated a significant financial surplus every year. The £11 million operating deficit in 2008-09 compares with a previously budgeted surplus of £4 million. The change reflects the unforeseen slowdown in the property market in 2008, which had the effect of greatly reducing ROS's fee-earning activity. The unforeseen deficit also resulted in ROS not meeting the financial target that the Scottish ministers set for 2008-09. However, because of its trading fund status, ROS has made no call on the Scottish budget. It has met the deficit from its reserves, which remain substantial. At the end of 2008-09, the balance on ROS's accumulated income and expenditure reserve was almost £123 million.

Looking forward, ROS's future finances will change significantly, in that it anticipates large deficits each year for the next five years. The projected losses are detailed in exhibit 2, which is on page 2 of my report. It is important to note that the projected losses are not solely the result of the recent downturn; they also reflect a decision in 2007 to reduce fees, as well as ROS's broader aim of maintaining stable prices for customers in the medium and longer run, while reducing the annual surpluses. Even so, the projected losses in the next five years are now about £25 million higher than was anticipated before the full impact of the downturn had been experienced.

The auditor of ROS considers that the future projections are subject to some uncertainty but that, nevertheless, ROS's overall financial planning and management of its reserves policy are effective. ROS has indicated to us that it will continue to keep its fees under regular review and that it will act should the position change because the recession has a deeper impact than is currently anticipated.

In summary, ROS incurred a large operating deficit in 2008-09 and forecasts more deficits in future. Those deficits are larger than previously forecasted because of the economic downturn, but ROS has substantial accumulated reserves to meet them and at the same time is continuing to develop and improve its services in line with its corporate plan.

It goes without saying that ROS must manage its income and expenditure plans to take account of future market movements and that it must make sure that those plans remain realistic. I have asked the auditor to continue to monitor performance on that, and if I think it is necessary, I will make a further report to Parliament in due course.

I am very happy to answer any questions that the committee has, with support from my team.

The Convener: You mentioned the historical situation with ROS having large reserves, and clearly it will draw on those reserves for the difficult period in which it is operating just now. Is it common for public organisations to be able to build up reserves in that way and then draw on them?

Mr Black: It would be unusual for a trading organisation such as ROS to build up such substantial reserves over a number of years. Although we have not reported it in the past, Audit Scotland has been aware of the build-up of more than £100 million in reserves over a number of years.

However, as we all know, there has been a period of substantial economic growth and prosperity over the past 10 years, with probably unprecedented levels of activity in the property markets. As a result, one would expect the reserves to increase. It would be entirely appropriate and good business practice for a body such as ROS to make provision in the good years and build up reserves to cope with the more difficult years in order to avoid any risk of calling on public funds. The level of those reserves on a year-to-year basis is a matter of judgment about the business of ROS. We are not prepared to comment on that; such questions should be addressed to ROS. However, it seems that the current situation is transitory and, as we outline in the report, the reserves are likely to decline substantially over the next few years.

The Convener: So there is nothing in the accounting rules to prevent a public body such as

ROS from building up reserves of the level that it has at the moment.

Mr Black: There is nothing to prevent that. If necessary, ministers have the opportunity to question a body such as ROS about the build-up of reserves and to take policy decisions in principle about the level of fees set and so on in consultation with the body concerned.

The Convener: When you carry out audits in the wide range of organisations that you cover, do you look at the level of reserves?

Mr Black: It is monitored through the audit process, yes.

The Convener: Do we have any way of knowing what the cumulative reserves are for publicly funded bodies in Scotland?

Mr Black: I would find it difficult to answer that question off the top of my head and, if I may say so, I would find it rather difficult to draw any conclusions from such a figure because the business environments of individual bodies are quite different.

The Convener: I understand that, but a substantial amount of money could be sitting in the reserves of publicly funded bodies, and we do not know how much.

Mr Black: In theory, that is the case. Can Dick Gill help us with that, on the basis of our audit involvement?

Dick Gill (Audit Scotland): It is important to remember that Registers of Scotland is a trading fund—I think that it is the only trading fund in Scotland—so it has a particular commercial position. By definition, it is an unusual body because of its status as a trading fund.

I emphasise that ROS has been looking carefully at its reserves policy over the past two or three years with questions and scrutiny from the auditor, so it is acutely aware of the issue. Ministers must set financial targets for ROS and I would expect them to take into account the level of reserves when setting fees, although that is, of course, a policy matter.

The Convener: Thank you. I will also ask about operating expenses. You have referred to the downturn in activity and the impact that that has on ROS. The operating expenses outturn for 2008-09 is £66.2 million. Given the difficult period in which ROS is currently operating—I refer to the downturn in activity—what is the explanation for the jump in operating costs for 2009-10 to £74.2 million, which continue to rise the following year and do not come back down to anywhere near current levels until 2013-14? Is there any correlation between operating costs and business activity?

Dick Gill: It is ROS's responsibility to account for and justify its spending. There will, of course, be a correlation between activity and operating expenditure. We report in the section 22 report that ROS's turnover in 2008-09 was significantly lower than forecast—a surplus of £4 million was forecast, but ROS ended up with an operating loss of £10 million. The picture on operating costs is similar, in that the budgeted operating costs for 2009 were, I think, £73 million but the outturn was £66 million. Therefore, there is some evidence that ROS's costs have reflected the reduction in activity, but the audit did not investigate that in depth, I am afraid.

Mr Black: The 2008-09 operating expenses were £41 million on staff, £12 million on equipment and service costs and £13 million on depreciation. We know from the work done on the audit that ROS continues to invest significantly in its information technology capability to improve the service that it offers.

Murdo Fraser: From my knowledge of Registers of Scotland—I used to be in legal practice—I imagine that the substantial proportion of its costs are staff costs, because it employs large numbers of people whose job is to check transactions. Given that there has been a substantial fall-off in the number of transactions, we would expect that there would be much less work for those people to do. ROS cannot simply sack them all, because it would lose the skills base that would be required if there was an uplift in the market. However, I would expect that people would leave and vacancies would not be filled, so it concerns me that the operating costs will go up over the next two years at least, which suggests that ROS is not making any attempt to reflect the lower level of transactions by having fewer staff. Do you have any figures for how the projected operating costs break down between staff costs, depreciation and IT?

Dick Gill: Will you give me a few moments to check that? In its published corporate plan, ROS sets out five-year projections, which are in exhibit 2 of the report. I am turning to my copy to find out how much information is included in those projections.

I do not think that the corporate plan reveals that level of detail, although it sets out plainly ROS's plans to improve its services. It is investing significantly in new technology. I do not know how that affects the underlying plans in the five-year projections, but I expect that it will have an effect on the organisation's operating costs. I also believe that ROS anticipates a recovery, which must be factored into its projections.

Murdo Fraser: Perhaps we can follow that up with ROS directly.

11:00

Nicol Stephen: I was surprised to discover that there is a trading fund in Scotland with a £123 million surplus. I was also staggered to read in paragraph 13 on page 2 of the report that ROS's

"total anticipated operating deficit over the five years to 2013-14 is £86 million."

The organisation is planning to operate with a deficit of £86 million over that period. It would be worth pausing and finding out more information about that before we leap to conclusions. It would be valuable for the committee to learn more about the trading fund and the criteria and objectives under which it operates. In order to do that, it may be necessary to speak to Registers of Scotland first and then the responsible minister. I do not know who the responsible minister is, although I assume that it is John Swinney—it would be interesting to find that out.

It might come as quite a surprise to the responsible minister to learn that there is a fund with a £123 million surplus sitting in it. Although ministers set clear objectives for Registers of Scotland, I would have thought that, in the light of the information in the report—the £123 million surplus and the plan to lose £86 million over the next five years, with higher operating costs and a significantly lower turnover than those in previous years—it would be at least worth revisiting those objectives and discussing them. A significant sum of taxpayers' money is involved.

The report is short, interesting and informative, and it could be quite valuable and important in the context of the current constraints on public spending in Scotland.

James Kelly: I agree with much of what Nicol Stephen has said. It would be worth considering matters further. Even if we assume that the losses to 2013-14 will be £86 million, that still leaves £38 million in the reserve fund. I would be interested to know whether anything could legally prevent the Scottish Government from making a call on reserve funds held by Registers of Scotland or other public bodies. It is clear that we are in a time of a lot of scrutiny of budgets, with tight public finances. It would be interesting to know whether there is any facility to call on such reserve funds and whether they could be used to fund other projects and help to boost the economy.

Mr Black: I am not sure whether we can fully answer the question about ministerial powers over ROS.

Dick Gill: The reserves policy is important for ROS. Among other things, it provides a property transactions indemnity. Cost consequences might arise if a title is not found to be sound. For that reason alone, it is important that ROS maintains some level of reserves. The actual level of reserves that there should be to satisfy that indemnity and meet the business's other requirements is quite a complex and technical issue, which the committee would have to speak directly to ROS about. Caution needs to be adopted.

James Kelly: The issue is worth clarifying.

Willie Coffey: If Mr Black's exhibit 2 was extended to cover an earlier period, we would see a very healthy picture of a profitable organisation; if it was extended to cover later years, we would see a broke organisation, with all its reserves used up. That is why members express concerns about quite severe fluctuations having been permitted in the organisation for a period of time.

It would be of interest to members to delve into the issue more deeply at some point to try to understand a bit better what is going on.

The Convener: Thanks for that. This is another item to which we will return later.

Palliative Care Action Plans

11:05

The Convener: I invite the Auditor General to provide us with an update on palliative care action plans.

Mr Black: With your agreement, convener, I invite Angela Canning to take you through that.

Angela Canning (Audit Scotland): Audit Scotland published a report on palliative care in August 2008, and the committee subsequently published its report in January this year.

The committee's report asked for an update from Audit Scotland on national health service boards' local delivery plans in relation to "Living and Dying Well: A national action plan for palliative and end of life care in Scotland", which the Scottish Government published in October 2008.

Our general observations are that, since the Audit Scotland team first started to examine palliative care, a lot of work has been done across Scotland, at local and national levels, to improve services. Scrutiny by Audit Scotland and the Public Audit Committee has raised the profile of this important service and has contributed to developments that are aimed at improving it.

The local delivery plans cover the 11 actions for boards that are set out in "Living and Dying Well", plus one of Audit Scotland's recommendations that was not addressed in that document, which is that boards should work with the voluntary sector to put in place commissioning and monitoring arrangements to ensure that value for money is achieved.

The Audit Scotland team considers that the Scottish Government went through a robust process to support boards in developing their local delivery plans. The Government issued a template that required health boards to identify actions against all the relevant actions in "Living and Dying Well". A review group assessed the plans against a number of criteria, such as ensuring that they cover patients in all care settings and with all conditions, not just cancer. That means that each board has a plan that covers all the actions and is intended to promote equal access to palliative care for all who need it.

Audit Scotland was invited to be present during the review process, and staff attended a meeting at which all the local plans were reviewed. The Scottish Government is continuing to monitor boards' progress and received updates from the boards at the start of October this year.

Our briefing paper for today's meeting also gives an update on other work that is relevant to the recommendations in the committee's report but which is not included in the boards' delivery plans, such as work that is being done on consistent national data collection, progress towards developing a national do-not-attempt-resuscitation policy, revised guidance on funding voluntary organisations and the work of several short-life working groups.

In summary, a lot of work is happening in relation to improving palliative care services. That will need to be evaluated in the future to ensure that all of that activity leads to real change and improvements for people. We will be keeping a watching brief on that.

The Convener: There has been welcome progress. What you report is commendable, and I am delighted that the Government, ministers and officials are taking the issue seriously. Any improvement that we can make in the service that is provided to people who are at this sensitive stage in their lives is to be commended. I am delighted to hear what you have to say about the progress that is being made.

Murdo Fraser: I agree with what you have said, convener. However, a number of pieces of information are due to be delivered. I see that the advisory group on "Living and Dying Well" is due to report in December and that there are two short-life working groups that are due to report in December. It would be useful if we could see those responses and reports when they are available, and perhaps do a follow-up thereafter.

The Convener: Do members agree to note the report and return to the issue at a later date?

Members *indicated agreement.*

Section 23 Report

"Improving public sector purchasing"

11:09

The Convener: Agenda item 5 is consideration of correspondence from the accountable officer on the Auditor General's section 23 report "Improving public sector purchasing". Again, I think that we have been given a fairly full response to our questions. Do members have any questions or comments about the response?

Willie Coffey: On the "Local businesses" section on page 3 of the response, I am encouraged by the comment that the Government will focus on allowing local businesses to participate in the grander procurement process, but I would like to see some evidence further along the line on whether that turns out to be the case. Examples from my constituency certainly suggest some concern about the extent to which local businesses can participate in the procurement process. Although the criteria may change as we move through the exercise, we should perhaps issue a wee caution that we need to see evidence that local businesses do not suffer any detriment in the procurement process.

Murdo Fraser: I concur with Willie Coffey's remarks. All members have experience of local businesses raising such matters with them.

On the "Standard terms and conditions" section on page 5 of the response, members will recall that we raised that point with the Government because the fact that different branches of the public sector utilise completely different terms and conditions makes it very difficult for tenderers—in particular, smaller organisations—to comply with them all. However, the final paragraph of the response states:

> "It is not possible to say when standard terms and conditions will be introduced, as there is no guarantee that consensus on a single standard can be reached."

I appreciate the difficulty that standardisation might present, but I think that we should encourage the Government to achieve that by providing leadership at the centre. The advantage of having standard terms and conditions would be tremendous, as it would help businesses that are seeking to win contracts. We should encourage the Government to do more to achieve that.

The Convener: Do we agree to write back to Stella Manzie to ask why it is not possible to say when standard terms and conditions will be introduced and what difficulties are anticipated that might result in failure to reach consensus on a single standard?

On Willie Coffey's point, shall we write back to ask for further clarification on the policy on local procurement?

Willie Coffey: We just need some assurance that local small businesses can participate fully and do not lose out in the procurement process. We just want to see proof of that.

The Convener: Okay. We will ask for that.

Nicol Stephen: On Murdo Fraser's point, I agree that we should ask the questions that the convener suggested, but I also think that it would not be unreasonable for us to ask for a target date. The Government sets target dates on all sorts of things that it does not have the ability to implement directly, such as in cases when delivery is provided by local government. Public procurement is a clear example on which the Government could show some leadership by fixing a target date. At the moment, there seems to be no will to do so.

The Convener: We can ask for that as well. We agree that we will take forward that work.

Agenda item 6 is the start of our private deliberations, so I must draw the public part of the meeting to a close.

11:14

Meeting continued in private until 11:53.

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

Members who wish to suggest corrections for the archive edition should mark them clearly in the report or send it to the Official Report, Scottish Parliament, Edinburgh EH99 1SP.

The deadline for corrections to this edition is:

Monday 16 November 2009

PRICES AND SUBSCRIPTION RATES

OFFICIAL REPORT daily editions

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

WRITTEN ANSWERS TO PARLIAMENTARY QUESTIONS weekly compilation

Single copies: £3.75
Annual subscriptions: £150.00

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.

And through other good booksellers

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, Subscriptions and standing orders
business.edinburgh@blackwell.co.uk

Scottish Parliament

All documents are available on the Scottish Parliament website at:

www.scottish.parliament.co.uk

For more information on the Parliament, or if you have an inquiry about information in languages other than English or in alternative formats (for example, Braille; large print or audio), please contact:

Public Information Service
The Scottish Parliament
Edinburgh EH99 1SP

Telephone: 0131 348 5000
Fòn: 0131 348 5395 (Gàidhlig)
Textphone users may contact us on **0800 092 7100**
We also welcome calls using the RNID Typetalk service.
Fax: 0131 348 5601
E-mail: sp.info@scottish.parliament.uk

We welcome written correspondence in any language.