# AUDIT COMMITTEE

Tuesday 27 November 2001
(*Afternoon*)

Session 1

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## Tuesday 27 November 2001



## AUDIT COMMITTEE
**17th Meeting 2001, Session 1**

**CONVENER**

*Mr Andrew Welsh (Angus) (SNP)

**DEPUTY CONVENER**

*Mr David Davidson (North-East Scotland) (Con)

**COMMITTEE MEMBERS**

*Scott Barrie (Dunfermline West) (Lab)
*Margaret Jamieson (Kilmarnock and Loudoun) (Lab)
*Paul Martin (Glasgow Springburn) (Lab)
*Mr Lloyd Quinan (West of Scotland) (SNP)
*Mr Keith Raffan (Mid Scotland and Fife) (LD)

*attended

**THE FOLLOWING ALSO ATTENDED:**

Mr Robert Black (Auditor General for Scotland)

**WITNESSES**

Mr Eddie Frizzell (Scottish Executive Enterprise and Lifelong Learning Department)
Mr Colin Reeves (Scottish Executive Enterprise and Lifelong Learning Department)
Mr Liam McCabe (Scottish Further Education Funding Council)
Professor John Sizer (Scottish Further Education Funding Council)

**CLERK TO THE COMMITTEE**

David McGill

**SENIOR ASSISTANT CLERK**

Anne Peat

**ASSISTANT CLERK**

Seán Wixted

**LOCATION**

Committee Room 1

# Scottish Parliament

## Audit Committee

*Tuesday 27 November 2001*

(*Afternoon*)

[THE CONVENER *opened the meeting at 14:00*]

**The Convener (Mr Andrew Welsh):** I welcome members to the 17th meeting of the Audit Committee in 2001. No apologies have been received. Mobile phones and pagers should be switched off.

Before we begin today's business, I want to record my thanks to Anne Peat, our departing senior assistant clerk, for all the work that she has done for the Audit Committee. I wish her well in her new role with the Finance Committee.

## Items in Private

**The Convener:** I seek the agreement of the committee to take items 2, 4 and 5 in private. Also, as members are aware, we have made provision for an extra meeting on 4 December to complete consideration of our draft Moray College report. I ask members to agree that, should we require the extra meeting, we will complete consideration of the draft report in private. Is that agreed?

**Members** *indicated agreement*.

**The Convener:** I remind the committee that items 2, 4 and 5 are internal matters concerning reports. I also ask members to note that the extra meeting, if required, will take place on Tuesday 4 December at 2 pm in committee room 3.

14:01

*Meeting continued in private.*

14:11

*Meeting continued in public.*

## "Overview of further education colleges in Scotland 1999/2000"

**The Convener:** I welcome our witnesses: Mr Eddie Frizzell, head of the Executive's enterprise and lifelong learning department, and his colleague Mr Colin Reeves, head of the further and adult education division of that department. We also have with us Professor John Sizer, chief executive of the Scottish Further Education Funding Council, and his colleague Mr Liam McCabe, director of financial appraisal and monitoring at the funding council.

Today we will examine the Auditor General's report "Overview of further education colleges in Scotland 1999/2000". I understand that the facts in the report have been agreed. In today's session, we shall ask questions on three main areas: the declining financial health of further education colleges; action taken by the funding council to encourage individual colleges to improve their financial health; and the potential impact that a range of recent developments may have on the financial health of colleges.

I understand that the witnesses have indicated that they do not wish to make an opening statement, so I shall begin by asking some questions about the financial performance of FE colleges since their establishment as independent corporate bodies in 1993.

Paragraph 2.5 of the report indicates that SFEFC took up its functions in 1999. Prior to that, responsibility for securing adequate provision of further education was exercised by the then Scottish Office education and industry department, which is now the Scottish Executive enterprise and lifelong learning department. What steps did the department take to address the financial problems of further education colleges prior to the creation of the funding council?

**Mr Eddie Frizzell (Scottish Executive Enterprise and Lifelong Learning Department):** After the period of incorporation, the department took a close interest in how the newly incorporated colleges were performing. It took that interest against a background of an increase in funding in the first year followed by a very flat baseline in expenditure. Clearly, there were issues to address with regard to how the sector would adjust to the new scenario.

Before 1999, the department monitored financial health in much the same way as I understand the funding council monitors financial health now. There were audit visits and the accounts were analysed. The forecasts that the colleges made were analysed and attention was paid to cash flow. On occasion, consultants were appointed to examine specific aspects, to analyse issues that arose and to make recommendations. On one occasion, people were sent in to examine what was going wrong in a college.

Some colleges' accounts were monitored monthly or quarterly and some colleges were required to produce recovery strategies. As far as I am aware, within the resources that were available to the department at the time, the same analysis of and interest in what was going on in colleges was adopted. Since 1999, SFEFC has continued and developed that.

**The Convener:** How close was the monitoring? You said that some colleges' accounts were monitored monthly and some were monitored quarterly. What criteria were used to decide whether colleges were monitored monthly or quarterly?

**Mr Frizzell:** The decision depended on the scale of the problem. The department had specialist staff who assisted with that. I do not know whether it would be helpful to ask Mr Reeves, who was directly involved in much of that work, to supplement my answer. The frequency of monitoring depended on the seriousness of the problem.

14:15

**Mr Colin Reeves (Scottish Executive Enterprise and Lifelong Learning Department):** Some staff who were attached to the department at that time were trained accountants. They formed a view about appropriate action after discussion with the college involved.

I cannot say that a set of rules governed whether a college's accounts were analysed monthly or quarterly. The department took the action that was judged appropriate after analysis of colleges' budget forecasts, cash flow difficulties and other matters. There was close dialogue between the department and all colleges, in particular those in financial difficulties.

**The Convener:** What did the department find? What was the state of the sector? Were major problems encountered? How widespread were they? When the department monitored the sector before the funding council was established, what was the sector's general health?

**Mr Reeves:** It is difficult to reach a view for the whole sector. When the 43 colleges were incorporated in 1993, they were in different situations. In the mid-1990s, some colleges came to terms with the new funding methodology, which encouraged growth and competition between colleges. In those years, the funding methodology was designed to achieve significant growth of student numbers, largely through competition between colleges and efficiency gains.

In the latter part of the 1990s, some colleges had achieved the necessary efficiency gains in the context of a funding quantum that had remained fairly static in the mid-1990s. Those colleges responded well to a funding methodology that focused on growth and efficiency gains. For various reasons—some of which concerned the quality of management—other colleges failed to make progress. Colleges were in difficulties ranging from one extreme to the other.

**The Convener:** I would like to form a general picture of the situation before the funding council was established. Why is it difficult to give a sector view? Were colleges doing well financially or badly? Were organisational problems experienced? How widespread were problems in the sector? Since the funding council's establishment, we have had figures on such issues. If the department monitored the sector, surely it knew what the general situation was.

**Mr Reeves:** Colleges were analysed individually; they were not placed in a set of categories. The action that was judged appropriate to each case was taken.

**The Convener:** How many colleges were in financial trouble? How many had organisational problems? How was the sector's health? If the department monitored the sector, it should know that.

**Mr Reeves:** The health of the sector is described in the figures in the Auditor General for Scotland's report and in the "Scottish Further Education Colleges: Managing Costs" report, which the Comptroller and Auditor General produced a couple of years ago. They give a picture of the sector as a whole. Within that picture, the 47 colleges were in a range of situations. At one extreme, there were colleges in acute financial difficulty, including Clydebank College and Reid Kerr College, and public action was taken to address the problem.

**The Convener:** I am not going to flog this matter, but out of the 47 colleges how many were in trouble and how many were performing well?

**Mr Reeves:** I am tempted to say that the lowest quarter of the colleges were performing especially badly, although a quarter of the colleges were performing well. I do not have exact figures to give the committee.

**Mr Keith Raffan (Mid Scotland and Fife) (LD):** I do not want to simplify the matter, but I presume that the whole point of setting up the funding council was to improve both monitoring and financial efficiency—otherwise, there would have been no point in changing the system. If it was so good before, why set up an intermediary body? I presume that the council was meant to be more hands on than you were hands off.

**Mr Reeves:** Yes. That was a significant factor in the setting up of the funding council.

**Mr Raffan:** When one looks at the work load of the council, to which the Auditor General refers in his report, one sees that it is very heavy for about 100 employees, with all these visits, recovery plans and everything else. It begins to look as though saying that you were "hands off" is a diplomatic understatement of what was going on. There had been almost a neglect of guidance to and monitoring of the sector.

**Mr Reeves:** The Government of the day had a view of the FE sector and allocated resources to it. Staffing resources were allocated within the Scottish Office and, within the parameters set, the sector was funded. You can see the figures in the tables, going back through the 1990s. The action that could be taken in the context of the available resources was taken.

**Mr Lloyd Quinan (West of Scotland) (SNP):** I shall see whether, through a third attempt by a third member, we can get some concept of the overview.

Surely, when it was decided to form the funding council, there must have been a piece of paper somewhere in the Scottish Office that clearly stated that there was a requirement for an organisation that would take an overview. The decision must have been based on your being able to take an overview of the entire sector. Would it be possible for you to direct us to an overview of the state of the sector in 1993? You appear to be unable to give us such an overview. Was there an internal document?

**Mr Reeves:** There was an examination prior to the setting up of the funding council.

**Mr Quinan:** Does that contain an overview of the sector?

**Mr Reeves:** It contains an analysis of the financial situation of each of the colleges.

**Mr Quinan:** Could that be made available to us, so that we could answer the question that you appear to be unable to answer?

**Mr Reeves:** The document was produced for the meeting between the two accounting officers when responsibility for FE funding was handed over from the Scottish Office education and industry department accounting officer to John Sizer, the new chief executive of the funding council.

**The Convener:** Could it be made available to the committee?

**Mr Reeves:** The document contains some commercial material that is confidential. I am not sure whether it could be provided.

**Mr Frizzell:** We will look into that and see what we can provide for you.

**The Convener:** I have a question for Professor Sizer. In 1999, what did you consider most needed to be done when you took over from the department?

**Professor John Sizer (Scottish Further Education Funding Council):** Prior to my taking over responsibility, I agreed with the Scottish Executive that I would second two of my accountants to work with Colin Reeves and his colleagues to produce an analysis of the financial health of the sector before I took it over. At the handover meeting with the then accounting officer of the SOEID, I discussed all the colleges about which I had concerns. That gave me a fairly good baseline from which to move forward.

I said a little bit about my overview of the financial health of the sector when I gave evidence to the committee on the National Audit Office's report on costs. That provided the basis on which I reported on the overall financial health of the sector, both to the audit committee of the funding council and to the council itself, at one of its early meetings. Broadly, I proposed to the council that the financial appraisal and monitoring framework for institutions that was being used by the Scottish Higher Education Funding Council be implemented by the Scottish Further Education Funding Council.

The key difference was that the systems that I put in at SHEFC when it was established and, prior to that, at the University Grants Committee were based on looking forward—anticipating problems and dealing with them before they became serious. That underpins the philosophy of financial monitoring.

When we inherited the further education situation, a large number of institutions were already in financial difficulties. To prioritise the work of Mr McCabe and his colleagues, we addressed those institutions first and worked on producing recovery plans, which are referred to in the report.

What I have said might be sufficient at this stage, but if you want more detail on the philosophy, Mr McCabe can add to that.

**Mr Liam McCabe (Scottish Further Education Funding Council):** Essentially, the approach involved forward-looking systems, as Professor Sizer described. I do not have more to add at this stage.

**The Convener:** What proportion of financial problems to organisational problems did you discover? Were there more financial problems than organisational problems, or was it vice versa?

**Professor Sizer:** There are three or four related matters. Colleges were incorporated from situations in which different local authorities gave differing degrees of empowerment to principals. I said before that many principals were appointed to do a different job, but were suddenly empowered to manage their institutions and inherited weak balance sheets. The colleges were not in strong positions. In addition, there was the financial and funding scenario that Mr Reeves referred to. There were different qualities of management with different degrees of experience and they inherited different problems.

Secondly, the quality of the financial people whom the institutions employed was variable. Since July 1999, we have been working to strengthen the quality of financial management in the institutions. Linked to that is the fact that many boards of management did not fully understand their responsibilities. Members will see from the report that we have been addressing that situation.

It is not accurate to say that the problem institutions were such simply because of the funding scenario. The problems came from a combination of the funding scenario and the ability of management to manage change. We have been supporting them in that since July 1999.

**The Convener:** Thank you. We have a fair bit of ground to cover, so we will now consider whether the causes of the poor financial health of colleges could have been avoided.

**Mr Quinan:** Paragraphs 4.19 to 4.24 of the Auditor General's report explain how the funding council developed its approach to monitoring financial performance and reviewing financial health at individual colleges. Despite that, the number of colleges with an operating deficit continues to increase. Are you satisfied that the current monitoring activities can identify financial problems well in advance?

**Professor Sizer:** You must be careful in interpreting what the Auditor General says in paragraph 4.16. He says that, on the basis of the forecasts,

"the number of colleges recording operating deficits will fall to 24 by 2003/4."

However, paragraph 4.16 does not include any absolute data on the extent of those deficits. In fact, the forecast is that deficits for 2003-04 will fall to £2.5 million, £1.8 million of which relates to one large college and £0.7 million to the rest of the sector. If you look at the percentage of operating deficits—

**Mr Quinan:** I actually referred to paragraphs 4.19 to 4.24, on the monitoring arrangements.

**Professor Sizer:** I am sorry. I thought you said paragraphs 4.16 to 4.19.

**Mr Quinan:** The question is about the monitoring structures rather than the figures themselves.

**The Convener:** It relates to paragraphs 4.19 to 4.24.

**Mr Raffan:** On page 34 of the report.

14:30

**Professor Sizer:** I am sorry; I am getting a bit demob happy. The question was: do I think the arrangements are effective? If one looks back at the trends in deficits forecasts, one must acknowledge that implementing action plans to turn things around does not imply that things can be turned around overnight.

I would argue that the overall trend is improving. That is reflected in the fact that we are picking up and addressing situations with the managements. At the same time, we can demonstrate that recovery plans for the situations that we inherited are being delivered and the cumulative deficits are disappearing. Remember that the cumulative deficits are based on operating profit, using current cost depreciation rather than historical costs. The liquidity of the sector is more effectively managed than it was in the past.

I am happy to go into more detail on the figures.

**Mr Quinan:** I was more concerned about your experience now that you have changed the monitoring structure. Have you had clear advance warning of financial problems or are you still suffering from internal problems in the colleges, which you cannot see arising, despite the monitoring?

**Professor Sizer:** On the whole, we are anticipating such problems. As the section on European funding demonstrates, one has to recognise that income in the further education sector is more volatile than in the higher education sector.

Things still crawl out of the woodwork, but we have created a situation in which, immediately problems arise, principals of institutions contact us. They do not sit on problems and they certainly tell their boards. We have changed the climate and now people realise that it is in their interests to inform us. If things come out of the woodwork between SFEFC receiving regular information or between monitoring visits, we generally know about them.

**Mr McCabe:** We have raised awareness generally. Professor Sizer is right to say that we have changed the culture to one of no surprises. It is better to be up front if there are financial difficulties. We have put a lot of emphasis on cash when immediate problems have arisen and there seems to be a better understanding of that.

We have worked with the finance directors on a detailed financial forecasting model. Initially, that was felt to be a bit bureaucratic, but we have simplified it and colleges are getting to grips with it, responding to it and using it internally for their own purposes. They are delivering a similar product to SFEFC as they are to their boards. Things are positive in that respect.

**Professor Sizer:** The last time that we met, I referred to hard hats and soft hats. If people acknowledge that they have a problem and come and tell us about it, we start with a soft hat and work hard to help. If they do not acknowledge the problem, we put our hard hats on.

**Mr Quinan:** Both answers lead rather well to my next question. Unfortunately, as identified in paragraph 4.9 of the report, 31 colleges—or three quarters of the sector—are returning 1999-2000 operating deficits that total £18 million. Why do you think that colleges are in such poor financial health?

**Professor Sizer:** Of course, the report is for 1999-2000. SFEFC only came into existence in July 1999. As I think I explained when I appeared to give evidence on the NAO report, we inherited situations in which institutions did not have strong balance sheets. They had no reserves to deal with the inevitable uncertain events that crawl out of the woodwork. Part of developing recovery plans is to strengthen balance sheets.

The funding model that we inherited was backward-looking and tended to create uncertainty because it was a model for sharing the cake based on the ability to recruit students two years previously. We have now changed that into a forward-looking funding model, in which we purchase capacity and people know, provided that they deliver that capacity, what their funding will be and have a good idea of what it will be in future years.

You have to be careful about that first year. The report is good and sets the baseline for future monitoring, but what it shows in relation to the first year's results does not reflect what we have achieved. Much more important are the results that colleges are forecasting—I emphasise that word—over the coming period. Although the number of institutions with deficits remains high, the absolute level of deficit falls to a low level—0.6 per cent of the total revenue by 2004. Those figures include one college that is forecasting an operating deficit—not an historical deficit—of £1.8 million, out of the £2.4 million total deficit that the sector is forecasting for 2003-04. The situation is showing improvement, as it should, given the fact that the Executive has invested a lot of extra resources in the sector.

**Mr Raffan:** The financial appraisal and monitoring services are not part of the executive of colleges, but have a role to play in guidance. I would like to know how the services relate to the colleges and the extent to which the colleges and the financial appraisal and monitoring services co-operate. You have partly answered that already.

**Professor Sizer:** I will let Liam McCabe answer that and then tell you whether I agree with him.

**Mr McCabe:** I am biased, but I can say that we are welcomed with open arms. The sector has felt that we have had to earn our spurs. We have had to demonstrate that we are there not to beat people with a big stick and wag our fingers at them about their financial health but can offer practical help and useful pointers in relation to the management of their financial affairs. It is a process of strengthening capability. We meet regularly with principals, boards of management and the finance directors en bloc and generally take an accessible approach. We are often on the phone and more often are at colleges helping them.

**Mr Raffan:** Would it be useful if you had some executive power?

**Mr McCabe:** Executive power?

**Mr Raffan:** Not only powers of guidance but powers of direction and the ability to intervene when you knew that a situation was out of control and send in a task force to set out targets that had to be met.

**Mr McCabe:** I cannot answer that question. Our focus has been on persuasion. In his report on Moray College, the Auditor General recognised that there are limitations as a result of that, but the sector has responded well. The impact of a change in our powers might be only marginal but I do not know.

**The Convener:** We will return to that issue in more detail later.

**Margaret Jamieson (Kilmarnock and Loudoun) (Lab):** In response to Lloyd Quinan's question, Professor Sizer said that the colleges that received European funding suffered some volatility. Will he expand on that?

**Professor Sizer:** European funding is soft money, not hard money. It takes the form of grants for specific periods to pay for specific tasks. Therefore, it is important that the costs that are incurred as a result of receiving the money are not built into the base. Institutions have to manage the funding which, although it is valuable and important for Scotland, is not guaranteed to be replaced by more European money. The management of that process creates volatility that requires effective financial management by the board and the principal of the college.

**Margaret Jamieson:** I totally accept that, because I understand that people make bids in relation to specific areas. Does the way in which the money is drawn down create volatility in the sector?

**Professor Sizer:** I am not involved with the bids for that money or its management. That is handled by the Scottish Executive.

**Margaret Jamieson:** But if there were a hiccup in the way that money is drawn down, it would create difficulties for the college.

**Professor Sizer:** It is true that at times there have been difficulties with the timings of draw down moneys, but we have been able to help smooth that by reprofiling our funding to recognise that there might have been a delay with European Union funding.

**Margaret Jamieson:** Have you had to step in and assist the sector when it is an issue that stems from the department?

**Professor Sizer:** I do not have powers to step in. If we have good, effective relationships with the colleges and they have problems, they are likely to come to talk to us about them. If there is a delay in receipt of funding from the European Union, they may well discuss with Liam McCabe and our funding team whether we can reprofile our funding to smooth the transition.

**Mr McCabe:** To put it in fairly crude terms, we do not function as a bank.

**Margaret Jamieson:** I know that.

**Mr McCabe:** We have to emphasise that fact when there are repeated requests for reprofiling. If something comes up at fairly short notice—in cases where there is a delay in European funding—we will advance grant in aid, but we would need to be certain about the cash flow that was expected and that we were not simply deferring a problem until later in the year. We have shown that we are flexible on that and it has worked reasonably well.

**Margaret Jamieson:** The European funding does not come from Europe directly—it comes through the department. Is there a problem in the way the money is issued to colleges?

**Mr McCabe:** I am not aware of a problem—it has not been brought to my attention. Sometimes, we have to deal with the consequences of potential problems. As Professor Sizer said, it is not something for which we are directly responsible.

**Mr Quinan:** I have a final question for Mr Frizzell. Exhibit 11 on page 27 of the report indicates that the number of colleges recording an operating deficit has increased between 1993-94 and 1998-99. What more could have been done—and by whom—to avoid that?

**Mr Frizzell:** I do not think that I can answer what more could have been done and by whom. What I can tell you is what has been done and by whom. I am a bit concerned that the snapshot of a position a year and a half ago has created the impression that we are locked into a difficult position. In fact, £0.5 billion extra has been put into the FE sector since the 1998 comprehensive spending review, which began to feed through only in 1999-2000. By 2000-01, roughly £40 million had fed through and the rest of the extra money will feed through between now and 2003-04. That should reduce the number of colleges in deficit, as indicated in the forecast, which shows the number falling from 31 to 24. More important, that money will bring the actual amount—the quantum—of the deficit down to something like £2.4 million, which is the figure that Professor Sizer quoted.

It has been recognised that more money needs to go into the sector. The current Government recognised that in the 1998 comprehensive spending review and in the spending review 2000. It has also been recognised on an ad hoc basis, with the use of extra money in-year, both last year and this year, to help the situation.

**Mr Quinan:** I extrapolate from those comments that if there had been an increase in funding each year between 1993-94 and 1998-99, there would not have been the same number of colleges in deficit. Therefore the deficit refers to the historical situation that the funding council inherited, as Professor Sizer mentioned. Are you suggesting that it was a straightforward case of underfunding during that long period from which we are currently trying to emerge?

**Mr Frizzell:** I am not saying that, and I do not think that Professor Sizer said that it was only historical underfunding either. He said that it could be a mixture of funding and management skills, and I am pretty sure that it was such a mixture.

We need to look at the figures. At that time, there was a different Government, whose priorities were different from the current one; there was a bearing down on public sector and unit costs, which is an issue that the committee was interested in when I first appeared before it; and we were undergoing a difficult change process in which colleges had to fly on their own instead of being under the wing of local authorities. As a result of a tight financial situation at a time of such significant upheaval in the sector and when new management was being introduced, it is perhaps not surprising that some difficulties emerged.

However, those difficulties are now being addressed.

14:45

**The Convener:** One thing that bothers me is the number of colleges experiencing deficits. I wonder whether they are on a treadmill. Does the money that is available to colleges more evenly match what they are expected to do, with the result that fewer of them will be in deficit? What about the balance of resources, given the tasks that colleges have to carry out?

**Mr Frizzell:** Perhaps Professor Sizer can answer your question in more detail. Broadly speaking, I think that there has been a 40 or 50 per cent increase in funding against a 10 per cent increase in student numbers, which means that the funding increases are not just keeping up with volume increases as far as activity is concerned. The spending review in 1998 suggested that, in the three years from 1999-2000, an extra 40,000 students would go into further education, but the financial increase over that period has been higher than that.

**Professor Sizer:** Although I cannot find the specific paragraph in the report, there is a breakdown of the additional funding that the council is receiving. That additional money provided extra volume, reduced pressure on resource and was invested in estates and in information and communications technology. There is a major problem with upgrading the sector's estates, which is the other situation that SFEFC inherited and about which the committee has some data. Furthermore, if, in this digital and e-learning age, the colleges are to play a full role the development of knowledge-based industries, it is important to invest extra resources in ICT. As a result, although part of the extra money was meant to improve the financial health of colleges and to buy extra capacity, part of it was meant to be used to create a better physical and ICT infrastructure.

**Mr David Davidson (North-East Scotland) (Con):** Mr Frizzell mentioned that funds that were apparently earmarked for the sector have yet to flow into it. Has any of that money been ring-fenced? Ring-fencing seems to be a problem for college management. I would appreciate specific details about what has been ring-fenced and where it is headed.

**Mr Frizzell:** Professor Sizer has already mentioned the output from the comprehensive spending review. An additional £15 million has been invested this year, £8 million of which is for capital and £7 million of which is to assist specific recovery. Furthermore, an extra £10 million was invested in capital the previous year. In the spending review 2000, money has been predicated for pay capital and adult literacy and numeracy. One or two areas have certainly been marked out for the extra money.

**The Convener:** I want to move on to consider why the situation has deteriorated over time and whether recovery action could have been taken earlier.

**Mr Davidson:** Professor Sizer, when you gave evidence to the committee in 1999 about the financial position of the colleges, you attributed their poor financial health to a high cost base, increasing student numbers and variations in management practice. Have your views changed at all since then?

**Professor Sizer:** Although the problem of the variation in management practice has been addressed, my views have not changed. The NAO report showed that there were significant variations in the cost base, and part of the purpose of recovery plans is to deal with colleges whose cost bases are too high.

What was the third issue?

**Mr Davidson:** The three issues were the high cost base, increasing student numbers and the variation in management practice.

**Professor Sizer:** As I explained, the previous competitive funding model drove institutions to go for growth, which resulted in increasing student numbers, but they found that growth was not necessarily adequately funded. We have created a situation in which we purchase a certain number of sums, which are the way in which we measure activity, at a set price. Institutions are no longer driving for growth and finding that it is not adequately funded. We control funding by clawing it back if there is under-recruitment and by not rewarding over-recruitment. The system is more disciplined now than it was when I took over in 1999.

**Mr Davidson:** I have a supplementary on that. Are the colleges fully brought in to the package through the Association of Scottish Colleges, or does the discipline come from the funding council?

**Professor Sizer:** Not only the ASC is involved—the chairs and principals are brought in. During the management review, they were heavily involved in the work that the consultants undertook and they did self-evaluations and produced action plans, on which we have commented. There was no resistance to their inclusion.

We undertake various activities with the ASC. It would always like more money and I am sure that if it made a submission to the committee it would ask for more money. That is life. There is strong recognition in the sector that to justify the extra investment, institutions must demonstrate that they are delivering value for money.

As I said before, a new generation of principals is coming through and some high-quality people have emerged. I do not want to criticise the group of principals who were involved with the incorporation because they were appointed to do a different job. New principals are being appointed and clear evidence shows that they are performing well. That reflects a commitment by the chairs of the boards of management and the ASC to work on management development. It put together a major programme on leadership development and management with the Kellogg school of management from the States, which will be run this month and which we will partly fund.

**Mr Raffan:** I understand that Fife College of Further and Higher Education and Glenrothes College now share a finance director. Is that the kind of innovation that you would like as it involves improving and sharing best practice and achieving more uniformity?

**Professor Sizer:** Yes. Similar sharing of best practice takes place in the Glasgow colleges group. We undertake area mapping and get groups of institutions to consider how they should work together in their region. Part of that is to ask whether they can make more effective use of resources, perhaps by finding a more capable person and sharing them at a high level.

**Mr Raffan:** You want institutions to move together in that way.

**Professor Sizer:** I certainly do. I would have no problem if the committee came to that conclusion.

**Mr Davidson:** Section 2 of the Auditor General's report provides details of the roles and responsibilities of the major players in the FE sector. The role of the funding council is detailed from section 2.5 onwards. Did you receive any kind of advice or guidance from the department on resolving the financial situation? If so, what was it?

**Professor Sizer:** As I said, I had a hand-over meeting with Mr Gerald Wilson, who was then the accountable officer of the Scottish Office education and industry department. Part of that hand-over meeting was to explain precisely the funding commitments and the financial health of the sector. At that meeting, Mr Wilson did not give me detailed guidance—I suspect because he felt that I did not need it as I was running the Scottish Higher Education Funding Council. I like to think that I am reasonably strong in that area. The Scottish Further Education Funding Council received a letter of guidance from the minister and, as the accountable officer, I received the standard guidance on the roles and responsibilities of accountable officers.

We have a financial memorandum and a management statement with the Scottish Executive. On this matter, as I explained earlier, I wanted to ensure that I received the information that I needed at the handover point. I seconded some people to work with Mr Reeves to ensure that the information was available for me. I grilled Mr Wilson carefully about all the problem colleges that I inherited. We had a fairly detailed discussion on every one and a detailed minute was produced.

**Mr Davidson:** Are there any areas—with the benefit of hindsight, which is a wonderful thing in management—on which you had insufficient guidance or on which you suggest the new incumbent in your role should seek guidance?

**Professor Sizer:** I do not think that I was short on guidance. We probably underestimated the extent of the problems that we inherited. I would not point the finger at the Scottish Executive on that. We underestimated the problems. It is fair to say that the monitoring on the SHEFC side suffered a little as a result of that. On the other hand, we had tight systems in place on the HE side. I do not think that it was a question of more guidance.

As far as my successor is concerned, I should not worry too much: he worked for the NAO and he worked with me at the University Grants Committee on setting up financial monitoring systems there, as a member of staff. He was director of funding for the Polytechnic and Colleges Funding Council—his responsibilities included financial appraisal and monitoring—and he was director of funding for the Further Education Funding Council. His responsibilities there also included financial appraisal and monitoring. He probably knows more about this area than I do.

**Mr Davidson:** Mr Frizzell might want to comment on this matter, because the department is involved in it.

**Mr Frizzell:** On guidance for the future?

**Mr Davidson:** Yes.

**Mr Frizzell:** Professor Sizer is right: what SHEFC has been doing with higher education is regarded as a good exemplar of what could be done for the further education sector. As I recall, that was one of the considerations that weighed with the Garrick committee, which recommended that a further education funding council be set up. There is no question in my mind but that it is easier to locate expertise in a body such as that, on which people are working in an area with which they will become familiar, than to try to do it all from the Government department. Getting SFEFC set up has been one of the significant successes.

There is no shortage of guidance through strategic steers, at least annually, from the minister and there is the usual financial and management guidance. There is a financial memorandum, a management statement and there is usually a letter every time—it has been every time in the recent past—extra money has gone in. A letter of guidance generally comes, saying why extra money is being put in. That goes back to the point about ring-fencing. The funding may, for example, be to help college recovery and should not go into the overall melting pot for capital expenditure. It is supposed to be strategic guidance, not telling them how to do their job, because they know how to do it.

**Mr Davidson:** This question is for Professor Sizer. You inherited a position where many of the colleges had deficits. What strategy did you adopt to tackle the problem? Are you satisfied that it is working?

**Professor Sizer:** What strategy did the council adopt?

**Mr Davidson:** Yes.

**Professor Sizer:** We must bear in mind that I just work for the council. There happened to be five accountants on the council. The council members decided that it should not only have a strong audit committee, which it has, but that all financial information should be reported in full to the council, so that it could take its strategic and operational decisions with full knowledge of it.

The council was clear in its mind that it had to complete the work that had been started by the Scottish Executive on revising the funding model, so that it created more certainty in the funding scenario, and that it had to recognise that if it was going to change the funding model it had to ensure that there was funding for transitional change and we did not make step changes in the funding. The council provided transitional funding for colleges that faced reductions in funding as a result of moving to a more effective model. That was an important decision, because it allowed those colleges to develop plans to adjust to the new funding base over a reasonable period. That gave us some certainty about how the transitional funding would roll out.

The funding council's audit committee has asked for regular detailed reports from Liam McCabe and his colleagues on progress in individual colleges. That committee initially said that it would adopt the categorisation of financial health that SHEFC had used, but, in the light of its experience, it has now refined that categorisation. That reflects how SHEFC has tried to ensure that, in making decisions about institutions and about its overall strategy, it was well informed on financial heath and was satisfied that the monitoring mechanisms were working and that we were giving good guidance. We have given all sorts of guidance over the period covered by the report.

15:00

In addressing the more strategic issues, SFEFC was determined that decisions concerning the most appropriate future shape of provision in the FE sector, particularly in Glasgow—the Glasgow colleges are referred to in the final part of the Auditor General's report—should not be driven by short-term financial consequences, but rather through determining the appropriate academic structure to meet Glasgow's needs. We sent clear messages to the Glasgow colleges group that we were keen to work with it and were willing to support it in dealing with some of its financial problems, particularly those involving the colleges' estates, but only in the context of a clear academic strategy for the Glasgow area.

**The Convener:** We will consider the situation in Glasgow in more detail.

**Professor Sizer:** Was that a sufficient reply, Mr Davidson?

**Mr Davidson:** Yes, thank you very much.

**Professor Sizer:** You asked some interesting, but rather broad, questions, and I am never quite sure when to stop.

**The Convener:** I would like to press on, as we have a fair bit of ground to cover.

Of the 43 incorporated colleges, 31 recorded deficits in 1999-2000, yet the colleges must maintain sound financial management systems, inform the funding council of likely deficits and clear deficits within a reasonable time. We need, therefore, to consider whether the funding council is in a good position to identify at an early stage colleges that are in a poor financial state.

**Mr Raffan:** My comments stem from paragraph 4.21 on page 32 of the report. I want to ask about

"SFEFC's assessment of the financial health of each college"

and about your categorisation system, which you have already mentioned. I want to see whether I have this clear in my own mind.

Is it the case that the categories or criteria are a mixture of exhibits 12, 13 and 14? Those are the tables in the report headed "College operating surpluses/(deficits) 1999/2000", "College accumulated historic cost surpluses/(deficits)" and "College borrowings" or "Availability of cash balances to meet average daily expenditure". Is it a mixture of those three criteria, plus the historic track record of the college?

**Professor Sizer:** Liam McCabe may have more to say about this, but I would start by pointing out that part of our assessment is an assessment of the quality of the financial systems and management of the institution. We do not rely simply on the numbers.

**Mr Raffan:** And what relative weight do you give to—

**The Convener:** Liam McCabe wishes to add something.

**Mr Raffan:** Sorry.

**Mr McCabe:** As part of the recategorisation, we recognise that the HE model that we use—it worked well for that sector—did not quite make it clear why an institution or college ended up with a particular category. We have recently set out to make the categorisation more numbers focused and based on the forecast. We have tried to assign values within ranges—it can be quite technical—and have focused on operating performance, on liquidity and on balance-sheet strength. We use different weightings for each of those.

SFEFC will shortly issue a circular letter on the matter. If it would help the committee, I could make that available.

**Mr Raffan:** It seems to be a complex matter. I will pick an example—Lauder College—with which I am familiar. The college has quite a high in-year deficit, although it is not greater than 5 per cent of its income. It has a relatively low historical cost deficit but it seems to be borrowing an awful lot. How do you judge its health in that context? Perhaps that will make the matter clearer to me.

**Mr McCabe:** We have acknowledged that issue. There was a mismatch of judgments. We take operating performance within a range of plus or minus 3 per cent. Colleges are scored against that. That is weighted quite heavily. We then consider liquidity in terms of number of days' expenditure within a range of 30 days normal commercial terms through to zero days, which scores badly. That is weighted quite heavily. We then consider balance sheet strength. If the worst came to the worst, does the institution have reserves onto which it could fall back? The second aspect to balance sheet strength is whether the institution is borrowing. If it is, can it meet the interest payments? That is weighted reasonably heavily.

Taking all those into account—I cannot remember the details for Lauder College—we arrive at an overall score. We then consider a risk assessment based on our visits to the institutions, during which we would examine the effectiveness of the financial management and the financial governance. We try to arrive at a holistic approach. That takes a lot of objective analysis and a little bit of professional judgment.

**Mr Raffan:** I look forward to reading that answer in the *Official Report* two or three times. I will be able to digest it. I thank you for the detail.

In 1999-2000, 19 colleges were judged to have serious financial health problems. Will you explain why so many—nearly half—were in that category and none were in the low risk category? Perhaps you can also mention what the four categories are. I know about the serious problems category and the low risk category. What are the two intermediate categories?

**Mr McCabe:** There is a range because of the number of institutions. At the top end of that range, we dip into those institutions about which we do not particularly need to worry. We focus our monitoring on those with the greatest need.

**Mr Raffan:** Why were so many in that category?

**Mr McCabe:** The answer to that goes back to the answer to an earlier question: SFEFC inherited the situation.

**Mr Raffan:** We are going over old ground. I refer to Professor Sizer's earlier answers. To move out of the serious problems category, colleges have to follow a recovery plan.

**Professor Sizer:** Yes. As I explained when we last met and discussed Moray College, we do not approve recovery plans, we give guidance. We give guidance on whether a recovery plan is robust. If we say that it is not robust, we generally find that the college's board of management is willing to address that. Colleges also have to seek my approval for borrowing. If I am not satisfied that a college's recovery plan is robust, I would have difficulty agreeing to borrowing. We have various indirect ways of ensuring that robust recovery plans are in place, but in the end we cannot impose them on colleges.

**Mr Raffan:** Yes, so you have leverage. You said that, in general, colleges accept your guidance as to whether their recovery plans are robust. Have there been specific instances when they have told you to disappear?

**Professor Sizer:** No—

**Mr Raffan:** In general, they co-operate.

**Professor Sizer:** If I put my hard hat on, it is difficult for colleges to tell me to do that.

**Mr Raffan:** In the last sentence of paragraph 4.21, there is a reference to SFEFC's proposed refining of the financial categorisation system. That was mentioned earlier. You also said that you wanted to make it more sophisticated. How will you do that?

**Professor Sizer:** Liam McCabe described the revised system rather than the old system. The revised system scores a balance of objective, quantitative financial information using a revised scale. If I recall rightly, using that revised scale, one college comes out in the "no worries at all" category and a large number are in the category that they "do not give us cause for concern". There are also those that we have to keep a closer eye on and those that we have to ensure have robust recovery plans. All those colleges will be on quarterly monitoring and some of them will have to provide us with weekly cash-flow information.

**Mr Raffan:** Are you saying that the revised system is already in place?

**Professor Sizer:** Yes.

**Mr Raffan:** The system is not a proposal; it has been implemented.

**Professor Sizer:** Yes. We are refining the system. What happened was that the council became concerned about the system that we were using. The council was concerned, as is Mr Raffan, about the large number of colleges in the lowest category and thought that it would be helpful if we could refine the system, so as to differentiate between those who had major problems and those who were just about to have problems. The new system breaks into two groups the weakest category in the old system. I will ask Liam McCabe to confirm that that is correct.

**Mr McCabe:** We are concentrating our efforts on the unsatisfactory and poor categories of college. There are also stable and good categories of college. The idea is to drive all colleges towards the good category.

**Mr Raffan:** Thank you.

**The Convener:** Nevertheless, using your own categories, in 1999-2000, none of the colleges was categorised as low risk and 19 colleges were judged to exhibit serious concerns. In paragraph 3.7 of the Auditor General's report, the auditors draw attention to the fact that five colleges remain going concerns

"on the assumption that SFEFC's financial support to the colleges and access to bankers' overdraft facilities would continue."

Will Mr Frizzell confirm whether the department could decide that a college's financial health was of such concern that funding should not continue?

**Mr Frizzell:** That would be a dramatic conclusion for us to come to. I take it that the convener is referring back to before—

**The Convener:** I was referring to 1999-2000.

**Mr Frizzell:** Yes. The department would not have wanted to come to that conclusion. The statutory obligation to deliver FE means that, at all costs, we would have wanted to keep the college going. Those colleges were the ones that attracted most attention. From the minutes of the discussion between my predecessor and Professor Sizer at the handover, I see that they were being looked at actively at that time.

**The Convener:** We are talking about whether bankers' overdraft facilities and so forth were necessary to allow the colleges to continue. We are talking about financial meltdown. Does the department have powers to intervene and, if such a situation arose, would it do so?

**Professor Sizer:** That question is for Mr Frizzell.

**Mr Frizzell:** The minister has powers to intervene. As a last resort, the minister can fire the board, merge or close down colleges and so on. Under the current regime, if there were financial meltdown, Professor Sizer and I, or our respective people, would be in conversations already about that. We would be seeking to find a solution by looking to the funding council. If the funding council said to us that the problem was that we had not given it enough money, and that we had better give it more, we would have to consider that request.

**The Convener:** What powers do you have to intervene?

**Mr Frizzell:** We have powers to fire the board—

**The Convener:** Nobody wants to see that, but—

**Mr Frizzell:** We have nuclear option powers. When I last gave evidence, we discussed those powers.

**The Convener:** Nobody wants to see it, but how close are we to such a situation becoming a reality?

**Mr Frizzell:** I have had no representations from Professor Sizer that we are close to that. I look to Professor Sizer to advise me on that, because the council's monitoring system is the way that we receive early warning of such a situation. Some colleges are in serious difficulty, but the expectation is that they have recovery plans that will work. If the council thinks that a college's recovery plan is not going to work, it will be in dialogue with the college to get a recovery plan that will work. The department has backed that up with extra resources over the next few years to the end of the life of this Parliament. We hope that that will help recovery to take place, but we expect to have a dialogue about that.

**The Convener:** We also hope that it does not happen. Perhaps Professor Sizer could answer the question about how close we are to using nuclear option powers.

**Professor Sizer:** Committee members should not assume that overdrafts are a bad thing. Members might occasionally have had one themselves. Overdrafts are not a problem provided that there is adequate cover to pay the interest and cash flow is fine. What is important is effective management of cash flow.

If the council came to the view that there was a problem that could be resolved only by putting in a disproportionate amount of resources, at the expense of other colleges, the council would have to decide whether it would do that or whether it would advise the minister that there was a fundamental problem that could be resolved only by action involving merging with another institution. Before that point was reached, I suspect that the minister would want to talk seriously with the board of management and to suggest that it might need to think about merging with another institution. However, in my time, we have not advised a minister to close an institution, although we have had one or two problems that might have resulted in our giving that advice had they not been resolved.

15:15

**The Convener:** As ever, the size of the overdraft is the problem.

On a more positive note, we will consider recovery plans.

**Mr Raffan:** I have a brief question for Mr Frizzell. The minister has the power to remove board members other than the principal. What happens if the principal is incompetent?

**Mr Frizzell:** That is a matter for the board, which employs the principal. That takes us back to the issue of whether there are the right kind of boards that know the kind of principals to employ, the standards to require, the targets to set and so on.

**Professor Sizer:** If the principal were incompetent and damaged the college's future, I would have no hesitation in telling the chairman of the board.

**The Convener:** We will now consider the extent to which the funding council has been successful in encouraging colleges that are experiencing financial difficulties to produce robust recovery plans.

**Scott Barrie (Dunfermline West) (Lab):** Mr McCabe might have touched on this matter in an answer to a point that Keith Raffan made about Lauder College. Professor Sizer, how do you decide which colleges should prepare recovery plans as a result of financial difficulties or other problems? Why are some colleges asked to do so and others not?

**Professor Sizer:** Analysis of an institution's financial health using the categorisation system that Mr McCabe described leads one to conclude that the college cannot survive unless it takes action. As the accountable officer, I must ensure that it takes action.

**Scott Barrie:** What guidance or other support does the funding council provide to colleges to assist in producing recovery plans?

**Professor Sizer:** We have paid for a number of colleges to employ financial advisers—consultants—to help them to prepare recovery plans. Often, colleges do not have experience of that task. Sometimes, if the college does not have the expertise, we have provided specialist support such as legal advice and even resource management advice where redundancies have been involved and industrial relations issues have had to be handled as part of the recovery. On the whole, I take the decisions and report to the council on the advice and help that we give. The council takes the view that that is a positive way of helping colleges to deal with problems as opposed to saying, "Go away and produce a recovery plan."

**Scott Barrie:** Do you collate evidence on whether the colleges apply advice or guidance successfully?

**Professor Sizer:** Yes. Once a recovery plan is in place, we require quarterly monitoring in most cases. We may reduce the frequency of monitoring if it demonstrates that the college is making progress in implementing the plan. In some cases, we might monitor on a monthly basis, particularly if the college has cash-flow problems. A college is in difficulty when it runs out of cash—the difficulty is not what appears in its income and expenditure account.

**Mr Davidson:** Professor Sizer, you indicated how many colleges have produced recovery plans. From appendix 2 of the report, quite a number of colleges appear not yet to be in a position to produce plans. Are you satisfied with the pace of the colleges' progress in producing recovery plans?

**Professor Sizer:** I am surprised that you say "quite a number". Perhaps Liam McCabe can bring you up to date on where we are.

**Mr McCabe:** All colleges but one are far down the road in producing a recovery plan. We have had difficulty in getting a viable recovery plan from one college. When we gave evidence on Moray College at a previous meeting, that was touched on.

**Mr Davidson:** Why do colleges have difficulties in producing recovery plans?

**Professor Sizer:** Liam McCabe can give the details, but it must be recognised that recovery plans often involve downsizing. Downsizing involves reduction in staff numbers, which is a painful business and involves negotiations with the unions and ensuring that the motivation of the colleagues who remain is maintained. It is the iterative process of getting ownership. It is no use producing a recovery plan if it is not owned by the board, the management team and, we hope, the institution. That process can take time, particularly if strong views are held by the staff unions about the way in which the recovery should proceed.

**Mr Davidson:** That is the carrying out of the plan. The question was really about its formation.

**Professor Sizer:** That can be difficult. You are trying to form a plan and as part of that you are trying to get everybody on board. There are other issues as well, however.

**Mr McCabe:** There has been a tendency in some cases to underestimate the scale of the task. It is partly a volume issue, and partly due to the complexities that Professor Sizer has touched on. There are particular issues in relation to the skill set for the task. Quite closely linked is the management information that is required to produce a plan that can demonstrate recovery. The costing and financial information to underpin a recovery plan has not always been available and sometimes has to be created from scratch.

**Mr Davidson:** How do you assess whether a recovery plan is robust? In your eyes, and those of the council, do a set number of boxes have to be ticked?

**Mr McCabe:** Although we have certain criteria, we take an individual approach to recovery plans. No two colleges are the same and no two sets of circumstances that lead to recovery plans are identical. From a financial perspective, we consider whether the figures indicate that recovery will follow in the coming years and test the underlying assumptions on which those figures are based. I may be responsible for financial appraisal and monitoring, but I consult my colleagues throughout the council. We take a multidisciplinary approach. A big part of that is the education aspect. At the end of the day, what does recovery mean in terms of adequacy and efficiency? What are colleges going to be left delivering?

**Scott Barrie:** A few minutes ago, Professor Sizer talked about how the funding council ensures that recovery plans are working. For example, he indicated that quarterly reporting could become monthly reporting. What can the funding council do to ensure that college finances are given adequate priority and consideration by boards of management?

**Professor Sizer:** First, all financial forecasts, mid-year returns, annual returns and recovery plans have to be signed off by the chairman of the board of management on behalf of the board. We have to ensure that the boards, as the bodies primarily responsible for financial health, understand their roles. I have spoken regularly to chairs on that matter. We also provide guidance to boards and remind them about the requirements within the financial memorandum.

When we feel that the board is not taking its responsibilities seriously or when we get the impression that the board is dominated by the view of the principal, it is often equally important to engage with boards. I get involved if we get into a situation that the board really needs to understand. I will call the chairman of the board or the chairman of the finance committee. I have occasionally met the whole board to spell out clearly the expectations. The whole purpose of the system is to ensure that we pick those things up; then, if there is a need to engage and ensure that people understand, that is what we do.

We emphasise the boards' role in holding the executive to account. A section of the management review report deals with financial management and the roles of the board and the principal. Each board must examine a set of challenge questions.

We also emphasise to chairs and boards—through me, through our monitoring visits and through dealing with individual situations—the importance of having an appropriate range of financial skills on the board. If we think that a board is not well developed or balanced, we will draw that to the board's attention. We are also discussing with the Association of Scottish Colleges further work on continuing professional development for boards. Liam McCabe regularly participates in seminars that are organised by the ASC for chairmen and principals, at which he talks to them about their role and its relationship to our role.

**Scott Barrie:** I think that you would agree that the overview report seems to mirror many of the concerns in the Auditor General's report, "Governance and financial management at Moray College", regarding SFEFC's ability to direct a college towards taking specific action. Do you think that the funding council has sufficient powers? Is there an alternative approach to the funding council's apparent role of providing constant guidance and cajoling? Such an approach might enable colleges to address their financial problems more appropriately.

**Professor Sizer:** When we discussed the Auditor General's previous report on Moray College, he recommended that a review be undertaken in this area. Someone asked me whether I would say to the minister that I agreed that such a review should take place, to which I replied that I would if I thought that that was necessary. At the moment, we are awaiting the committee's report on Moray College, to which the minister will no doubt respond. I agree with the recommendation in the Auditor General's report that there is a need for that review, but I am reluctant to say what the outcome of that review should be. As I explained during my previous appearance before the committee, you should seek that view from the funding council. I am not going to risk saying things simply because I have another three weeks as chief executive of the funding council.

**Scott Barrie:** You are demob happy.

**Professor Sizer:** You may ask me that afterwards.

**Scott Barrie:** Mr Frizzell, when we took evidence on Moray College, you said that such a review was being undertaken. Can you indicate what progress has been made on the review?

**Mr Frizzell:** I said that I was sure that the minister would take seriously the views of the Auditor General and the Audit Committee, should a review be recommended. I assume that the committee will endorse that recommendation and that it will be in your report. Therefore, I can safely say that we will go ahead with a review. We are awaiting receipt of your report and its formal recommendation that a review should be undertaken. If that happens, we will get on with the review as soon as possible.

Some interesting questions arise. If one gives the funding council directive powers to force something to happen, one must always have at the back of one's mind what the sanction is and what we are trying to achieve. A big sanction would be closing a college or sacking all the managers, but would that deliver further education to the community concerned? Quite a few sensitive issues would have to be considered in the review. However, you can take it that, yes, the review will go ahead if that is what the committee recommends.

**The Convener:** Action has obviously been taken by the funding council, but I would like to look at the range of initiatives that have been proposed in order to see whether they will have an impact on future financial performance.

**Mr Raffan:** We seem to be knee-deep in reviews of management, supply and demand of FE, FE provision in Glasgow and college estate surveys. I want to concentrate on the management review. I understand that the key part is in paragraph 5.3 of the Auditor General's overview report, which refers to

"greater involvement of board members … the formulation of the college vision"—

whatever that may be—

"strategic and operational planning … marketing … financial management … and … comprehensive estate strategies."

I understand that you asked the colleges to produce management plans on the basis of the management review by March 2001. The plans then went to consultants, following which you fed back to the colleges last month. Has that process been completed?

**Professor Sizer:** We have done two things. First, we produced an overview report for the sector, based on an analysis of the colleges' action plans that was undertaken by consultants whom we employed for that purpose. Secondly, we provided feedback to every college. I should be happy to give the committee a copy of our overview report.

**Mr Raffan:** So each college has received feedback.

**Professor Sizer:** Yes.

**Mr Raffan:** Before I go on to the more general question, I want to ask about the comprehensive estate reviews and the problems with those. The required figure of £116 million is dramatic. I know that the Executive has made provision of £60 million, but I have seen at first hand the condition of the tower block at Fife College, which is a major problem. I am sure that there are major problems at all other colleges. That example underlines the importance of the estate reviews in catching up with the backlog of work that needs to be done. How detrimental is that to the colleges' ability to get into a position of financial recovery?

15:30

**Professor Sizer:** The condition of estates varies widely throughout the sector, depending upon how well the local authorities maintained them previously. I assure the committee that there are worse situations than that at Fife College. The £116 million was based on the minimum investment needed to address the existing backlog for the present estates. The view of the council is broadly that £250 million will be required in the medium to long term if we are to renew the estates rather than maintain estates that are, in many cases, no longer appropriate for the lifelong learning task that the colleges have to deliver.

The council has two funding streams. It allocates estate grants annually on a formulaic basis. We have just topped up the figure for this year with an extra £13.3 million—£8 million from the Minister for Enterprise and Lifelong Learning and £5 million that we found from slippage on what we had inherited. The other side of the issue is that colleges have to come forward with proposals, against a set of criteria, for the council to contribute to new developments. An example is the new Telford College campus that is planned on the waterfront at Granton, which the council will partly fund. We have fairly rigorous procedures to evaluate such proposals before we make a contribution.

In the case of the Glasgow area, which is probably one of the poorest inherited estates areas, we take the view that we should not make or contribute to major capital investments until we are satisfied that the academic infrastructure to deliver Glasgow's future needs is determined. That is why we set up the Glasgow colleges review.

The process will take time. As well as getting colleges to develop estate strategies, we find that many colleges do not have the experience and the expertise to develop major capital projects because they do not carry them out regularly. It is not like being part of a large public limited company. We find that we have to give small grants to help colleges to prepare their cases and develop their estate strategy. We are moving forward, but the job is fairly long term and the Minister for Enterprise and Lifelong Learning recognises that.

**Mr Raffan:** I come to the broader question of the management action plans. You obviously expect them to have a beneficial impact on the financial health of the sector. Is that a medium to long-term expectation?

**Professor Sizer:** The management action plans were not formulated by saying, "If we take this action, we will save this sum of money." They are more about improving the quality of governance and management overall. As Mr Raffan said, that should impact on the financial health of colleges.

As a follow-up, when Liam McCabe and his team undertake their audit visits, they will monitor how those action plans have been implemented. I think that I am right in saying that the National Audit Office report said that there should be a long-term monitoring process. We see action plans not as a one-off, but as a first stage in a process of continuous self-evaluation. We are identifying the lessons and sharing them with the sector. The council is developing action plans to address issues such as the development of courses for governors so that they understand their responsibilities, and the development of programmes on financial management and on various skills that are mentioned in the report.

Liam McCabe is developing that.

**Mr McCabe:** The idea is to embed the key messages so that they become part of the process. The exercise had to be done as a one-off to kick-start it, but the idea is that in the longer term, those messages will become embedded. The area in which we would like them to be embedded most of all is that of strategic plans and operational plans. As they come through, we can see the actions that were in the initial management action plan being fed into those key management processes.

**Professor Sizer:** The minister has made extra resources available to the council to appoint a director of further education development. One of that person's major responsibilities will be homing in on that issue and working with Liam McCabe and his colleagues to ensure that that does not slip.

**Margaret Jamieson:** Part 5 of the Auditor General's report refers to a review of supply and demand in the FE sector. When will that be complete? Obviously, it will not be in the next three weeks, so Professor Sizer will have to hand over to his successor.

**Professor Sizer:** The minister has responsibility for adequate and efficient provision and that responsibility is delegated to SFEFC. The council found that no one had defined adequate provision, so its first task was to map provision for a supply and demand service. The initial mapping of various areas has been done.

After the report giving an overview in Scotland, we first considered the Glasgow colleges area in detail. As the report says, mapping is progressing. We have also produced a report on the Highlands and Islands, which will be discussed with colleges in the new year. The pace with which we have developed those reviews has been determined by the resources that are available to the council. The minister is providing the resources to create not only an extra directorate, but a support team to work with the director. I assume that once the director is in post, the work will be speeded up.

We have also started mapping in Dunbartonshire, where colleges are considering their map, how they can collaborate more effectively and whether rationalisation is needed. As well as geographical areas, we are considering key employer sectors such as financial services, microelectronics, food and drink, manufacturing and construction, which are being mapped. The timetable in the report was based on the position before the new director was appointed. I assume that once the new director comes on board, the work will be speeded up.

The work is original—it has not been done before not only in Scotland, but in the UK. Our opposite numbers in England are examining our methodologies and hope to adapt them to the English scene.

**Margaret Jamieson:** I am sure that they will learn from the good work that has been undertaken in Scotland.

**Professor Sizer:** I am sure that they will.

**Margaret Jamieson:** The review will consider trends in employers' expectations and how we make them the expectations of the communities that SFEFC serves. However, any rationalisation will have other drivers. Does that mean that the number of colleges could reduce and that colleges with one site might progress to having three or four sites?

**Professor Sizer:** I expect the number of colleges in the Glasgow group to reduce.

**Margaret Jamieson:** I am not being specific. I may have a west of Scotland accent, but I am not too bothered about the Glasgow situation; I am asking about the whole of Scotland.

**Professor Sizer:** I am not talking to you because you may or may not be from Glasgow; I did not look that up before I came here. The Glasgow review was the first review. As a result, three colleges propose to merge, another two colleges propose to merge, and another proposal may be made. I do not know whether similar patterns will emerge from the other mappings.

The situation in Edinburgh is different from that in Glasgow. Edinburgh has three largish colleges, whereas Glasgow has 10. Mergers may emerge, but they are not the only option. One would hope that strategic alliances will be formed. Bigger, longer-term issues about the delivery of further and higher education are involved, on which I am sure Mr Neil's Enterprise and Lifelong Learning Committee will have thoughts.

**The Convener:** I think that the questions will return you to Glasgow quite soon.

**Margaret Jamieson:** My question is to Mr Frizzell. Paragraphs 4.7 and 5.12 of the Auditor General's report say that significant additional funds have been made available to the sector since 1999. You referred to that. How confident are you that the extra funds will enable colleges to reverse their accumulated deficits and move into financial stability?

**Mr Frizzell:** The forecasts certainly do not show that all the deficits will be eliminated in the next two years. The Auditor General's report forecasts that the number of colleges in deficit will fall to 24 and that the amount of money involved will also fall substantially. That gives one grounds for confidence that, once the money feeds through, the situation will improve.

We will be looking for advice from SFEFC on the likely current and future position of the sector for the spending review 2002. A mixture of money and management expertise will bring the colleges around. We believe that our extra investment should make a difference and there are signs that that is beginning to happen.

**Margaret Jamieson:** Do you have any say in how the money is released to the colleges? Given the significant sums of money that were released for capital projects and to fix some of the problems with estates, it seems that colleges are not being given the full funding but are being drip-fed amounts every month from now until the end of the financial year. If it costs X to fix a roof, you cannot ask the builder to do £50,000-worth of repairs one month and to come back next month to do another £50,000-worth. Is there not a problem with how funding is released?

**Mr Frizzell:** The department does not get involved in issues such as how and when the payments are released or how much is given to individual colleges. That matter is very firmly delegated to SFEFC. There was an element of drip-feed in the extra allocation this year to help colleges in recovery. We said what the £7 million was for and it was up to SFEFC to decide how to distribute the money and which colleges the money should go to. That targeted distribution was not really for all colleges, but for those that needed help with recovery.

**Margaret Jamieson:** Would you not indicate to SFEFC what you expect the outcome of providing that extra allocation to be?

**Mr Frizzell:** Yes. For example, we were quite specific about the allocation that I just mentioned. We sent a letter to SFEFC saying that the money was for speeding up the process of recovery, that we hoped that the council would target it at colleges that were clearly making an effort to recover and so on.

Some extra allocations that have been made quite specifically for capital arose from money that was saved from the previous year—not from this budget—and that needs to be spent before the end of the financial year. Which colleges receive the money is a matter for SFEFC.

The main allocations are settled annually and are not drip-fed from the enterprise and lifelong learning department. If we know that we have extra money to spend, we tend to make the allocations halfway through the year.

**The Convener:** As promised, we now turn our eyes westwards, to find out how provision of further education is likely to develop in Glasgow.

**Paul Martin (Glasgow Springburn) (Lab):** Professor Sizer, as paragraphs 5.7 to 5.10 point out—and as you have already mentioned—a review of further education services is under way in Glasgow. There has been a great deal of speculation and media reporting about the issue. What is the latest position on the review and when will you make the review's findings public?

**Professor Sizer:** The review was commissioned jointly by the Glasgow colleges group and SFEFC. The consultants have finished their report, which has been published, and the colleges have been consulting among themselves. The report basically sets out a range of options. SFEFC did not endorse any of those options, but simply told the colleges to go away and consider them. Again, it is important that the colleges had ownership of the situation. As we said earlier, some developments have already emerged. The colleges group has responded and SFEFC will discuss its response at its meeting on 6 December.

**Paul Martin:** But can you clarify what—

**Professor Sizer:** The colleges' response broadly supports the report's findings and proposals. They are keen to explore options other than the status quo. I cannot tell you in detail what is in the report that is going to the council on 6 December, partly because I have yet to read it. I know that it is coming and that it will be considered at the next funding council meeting. When we have our briefing with Esther Roberton, we will discuss it in detail and decide what we are going to do.

**Paul Martin:** We need some clarity on that. The other question that I raised was when you intend to make the report public.

**Professor Sizer:** In accordance with the Freedom of Information Act 2000, the council makes its agendas and minutes publicly available, unless there are confidential matters relating to individual colleges. Perhaps I could send the report to the committee after our meeting on 6 December.

15:45

**The Convener:** Could you give us an idea of the process? Given that the report goes before the council on 6 December, when will it be made public? Does it have to go through another procedure?

**Professor Sizer:** As I said, the report is a response from the Glasgow colleges group. Proposals for mergers between three colleges and two colleges are already in the public domain. Whether the council will decide to refer the report to its strategic development committee or to take action at the meeting of 6 December I cannot say. The council is yet to consider the report and I do not make the decisions—the council does. I am not trying to be difficult, but I cannot pre-empt what the council will do with a report that it has not yet seen.

**The Convener:** I understand that. I am interested in finding out the procedure to ascertain what the options are.

**Professor Sizer:** The whole philosophy that underlies the council's work, which is similar to my philosophy since I came to the Scottish Higher Education Funding Council, is that we must secure ownership of change. Therefore, it is important to be fully open and transparent. We cannot impose change on institutions. I have no doubt that if the colleges group wants the report to be in the public domain, the council will do that, but I do not want to commit the council to putting the report in the public domain until we have consulted the colleges group. It is a joint project. The colleges are keen to drive things forward. Nothing had happened to sort out the situation in Glasgow for God knows how many years and we have achieved a hell of a lot in about 15 months.

**The Convener:** Thank you for that clarification.

**Paul Martin:** When will the findings of the report begin to be implemented?

**Professor Sizer:** We have already provided grants to Stow College and North Glasgow College to support the costs of undertaking the merger evaluation and the due diligence. We will provide similar grants to the Glasgow colleges group. Any recommendations would have to go through the council to the minister. The minister must approve any merger. The processes are clearly set out: the proposal is made to the minister, the minister refers it to the council, the council advises the minister and the minister takes a decision. The timetable is always difficult to predict.

**Paul Martin:** It is important that a timetable is put in place. I appreciate that you will report on the matter to the ministers and that there is a certain protocol.

**Professor Sizer:** Yes.

**Paul Martin:** I want to confirm that there will be a timetable in place to ensure that there is clarity about how quickly the proposals will be implemented.

**Professor Sizer:** Yes. I expect the council to want advice on that from the strategic development committee. I may sound slightly aggressive, but I must emphasise that I have been surprised by the way in which we have been able to make progress, with the full support of all the chairmen and principals of the Glasgow colleges group. When I set out on this road, I was not confident that I could achieve that. So far the project has enjoyed an enormous amount of commitment and good will. Although it is important to have a timetable, I would not want to impose one that might damage the good will and ownership that we have secured, which is one of the council's more remarkable achievements since its establishment.

**Paul Martin:** We can clarify the point that there is a need for a timetable.

**Professor Sizer:** I agree with that.

**Paul Martin:** We have already touched on mergers being discussed and informal discussions taking place within the Glasgow group of colleges. What are the benefits of such mergers? I understand that there is an informal process whereby the colleges are entering into negotiations on possible mergers—correct me if I am wrong. Do you support groups of colleges coming together to negotiate possible mergers?

**Professor Sizer:** The colleges will have to produce a proposal that meets a set of mergers criteria. We have given guidance to the colleges on the format of such proposals. The proposal will go to the minister who will then seek the view of SFEFC, and might well set an examination paper for the council. The funding council will have to evaluate the costs and benefits of the proposed merger and report on that to the minister.

If a merger is approved, SFEFC might provide strategic funding to help in that journey and to ensure that the merger is implemented as effectively as possible. The people who are proposing the merger must demonstrate that the added value of the merger outweighs any costs.

**Paul Martin:** From your experience, can you advise the committee on what benefits would come from a merger?

**Professor Sizer:** My experience is in higher education. There were benefits in merging the teacher education colleges with their parent institutions. First, most teacher education colleges were subject to short-term financial monitoring and had serious financial problems that inhibited their ability to develop. Secondly, we saw the benefits of integrating teacher education into a much broader environment and, in particular, in the development of concurrent degrees. Thirdly, there were significant benefits for the management of central administration costs and estates and other matters that require professional expertise.

At the moment, many small colleges have a higher ratio of administrative costs to total costs than they would if they were part of a larger college. There are therefore real benefits to mergers, but it is important that those are demonstrated to the minister and SFEFC.

**The Convener:** We are heading towards the end zone of a very long meeting. Scott Barrie has questions on how the funding council will prioritise funding for each of the initiatives to ensure that maximum benefits are gained.

**Scott Barrie:** The range of initiatives that is set out in part 5 of the report represents a heavy work load for the funding council. Can you give the committee an idea of how efforts will be prioritised to provide maximum benefit to the FE sector?

**Professor Sizer:** The initiatives are not just being carried out by the financial appraisal and monitoring directorate. They are being carried out by all council staff and they are integrated. Therefore the review of supply and demand, which will lead on to analysis of what the structure of the sector should be and what estates will be needed, is critical to SFEFC. If we are going to fulfil the responsibility to offer adequate and efficient provision, we must get the overall strategy and structure right. In order to make that structure effective, we must get the process measures right—they will come from the management review. So the order is: strategy, then structure, then process.

The management review is already in place; it arose from a request by Helen Liddell and from the National Audit Office's review of the cost base. However, until we have the review of supply and demand and until we have a better understanding of what Scotland's future needs are and what the shape of the FE sector should be, dealing with those process measures will not necessarily lead to a more effective sector. One can be efficient only if one is effective.

**Scott Barrie:** Turning to the establishment of the new further education development directorate, what are the key priority areas for the directorate and how do you intend to monitor its performance?

**Professor Sizer:** It is a bit unfair to ask me how I will monitor its performance, because I am not involved in the process of appointing the director. The proposal for the new directorate arose partly from discussions about my retirement and my successor. However, it also arose from the fact that, as I said, it is possible that we underestimated the demands that we faced on the FE side.

My team has been heavily stretched, but we had a real advantage in having a team of people who are used to working together and moving things forward. However, there was a need to strengthen structures, so two new directorates are being established. One is on research policy, which is more related to the HE side than it is to the FE side. The role of the new FE directorate is set out clearly in paragraph 5.13 of the report. The new directorate's role will be to integrate the strategy and the structure, through to co-ordinating the work of supporting colleges that face complex and difficult management problems.

When I wrote the job description and worked out the structure beneath it, it was on the clear understanding that my successor might want to review that in the light of the appointments and of his own views. It is difficult for me to say how I would evaluate something that might not finish up in the shape that I originally put in place to allow the recruitment process to happen. The interviews took place yesterday. I was not involved in them, but my successor was. I have not yet had a report.

**The Convener:** We end with two short, sharp questions on when the financial health of the sector might improve and stabilise. Paragraph 4.16 of the report indicates that the number of colleges recording operating deficits will have fallen to 24 by 2004. Is that good enough?

**Professor Sizer:** As I emphasised earlier, that would lead to a fall in the deficits from 3 per cent of income to 0.6 per cent of income. One college accounts for £1.8 million of the deficit that is forecast for 2003-04. Subject to the dangers of forecasting—who anticipated the events of 11 September?—the forecast liquidity situation also suggests that in about a couple of years we will see stabilisation. The next stage in strengthening the balance sheets will move forward from that point. It is one thing to stabilise, it is another to create strengths that will deal with future uncertainties—I cannot guarantee the latter.

**Paul Martin:** What will be the main reasons for the improvement of the financial performance over the years to 2004? What will ensure that there will be an increase in the performance of the colleges and why are you so confident that we will have that improvement?

**Professor Sizer:** I am sorry if I gave the impression that I was so confident. I am certainly more confident than I was two years ago, although my optimism is subject to the vagaries and uncertainties of the world. First, extra funding has been put in. Secondly, there has been a significant improvement in the quality of management—we have noted the turnover of principals—and in ownership of the boards. The boards have recognised their roles, which had not previously been clear.

The benefits of economies of scale are becoming apparent: putting more funding into a college results in more students, which inevitably produces larger class sizes and economies of scale. Having said that, the pay and conditions of staff—which are not the responsibility of the Scottish Further Education Funding Council—are potentially major issues that need to be addressed. The pay of further education staff seems to have got out of line with the pay of school staff as a result of the McCrone recommendations. It is one thing to claim that McCrone's forecast will stabilise the situation, but many of the improvements that have been made are the result of maintaining morale and motivation of staff. To build on what we have achieved, my successor and the minister might well have to address those human resource problems as a major priority.

**The Convener:** We have covered a great deal of ground on a wide range of topics in an important subject. Although Professor Sizer is retiring, stamina is clearly not a problem. I thank all the witnesses for their attendance and I offer the committee's special thanks to Professor Sizer, because it is likely that he will not appear before the committee again. He and Mr Frizzell were the first witnesses that the committee heard from in September 1999. We want to wish Professor Sizer well in his retirement and we look forward to resuming our acquaintance with Mr Frizzell in future.

Thank you for your attendance and your contributions to the debate.

**Professor Sizer:** Thank you. Before I go, I should say that we worked closely with the Auditor General's staff on the report. I very much appreciate the relationship that we have had with him and his colleagues, which I hope will provide a basis on which future progress can be made.

**The Convener:** We move now into private session.

16:02

*Meeting continued in private until 16:27.*

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