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Pàrlamaid na h-Alba

Official Report

PUBLIC AUDIT COMMITTEE

Wednesday 2 February 2011

Session 3

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PUBLIC AUDIT COMMITTEE
3rd Meeting 2011, Session 3

CONVENER

*Hugh Henry (Paisley South) (Lab)

DEPUTY CONVENER

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

COMMITTEE MEMBERS

Willie Coffey (Kilmarnock and Loudoun) (SNP)
George Foulkes (Lothians) (Lab)
*Jamie Hepburn (Central Scotland) (SNP)
*Mr Frank McAveety (Glasgow Shettleston) (Lab)
*Anne McLaughlin (Glasgow) (SNP)
*Nicol Stephen (Aberdeen South) (LD)

COMMITTEE SUBSTITUTES

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

*attended

THE FOLLOWING ALSO ATTENDED:

Mr Robert Black (Auditor General for Scotland)
Angela Cullen (Audit Scotland)
Dick Gill (Audit Scotland)

CLERK TO THE COMMITTEE

Jane Williams

LOCATION

Committee Room 6

Scottish Parliament

Public Audit Committee

Wednesday 2 February 2011

[The Convener *opened the meeting at 10:00*]

Decision on Taking Business in Private

The Convener (Hugh Henry): I welcome members, Audit Scotland staff and members of the public to the third meeting in 2011 of the Public Audit Committee. We have received apologies from George Foulkes, who is being substituted by James Kelly, and Willie Coffey. I remind members to switch off all electronic devices.

Item 1 on the agenda is to seek the committee's agreement to take item 4 in private. Do members agree?

Members *indicated agreement.*

Section 22 Report

"The 2009/10 audit of the National Library of Scotland"

10:01

The Convener: Item 2 is consideration of a section 22 report, "The 2009/10 audit of the National Library of Scotland", which, as members will be aware, was laid in Parliament on 22 December 2010. However, as the issues that it identifies are sub judice, I invite members to agree to note the report and to include it in our legacy paper to ensure that our successor committee considers it once the sub judice factor is no longer an issue. Are members agreed?

Members *indicated agreement.*

Section 23 Report

"Management of the Scottish Government's capital investment programme"

10:02

The Convener: Item 3 is consideration of a section 23 report, "Management of the Scottish Government's capital investment programme". I invite the Auditor General for Scotland to brief the committee.

Mr Robert Black (Auditor General for Scotland): Thank you, convener.

I am sure that members will recall that, back in 2008, we presented to the committee our first across-the-board review of the management of major capital projects in Scotland. That earlier report looked at the track record of projects, particularly in relation to cost and time targets, and this latest report provides an update on the performance of 55 projects that have been completed most recently at a combined cost of £2 billion. However, in this report, we also take a broader look at the framework for running the whole investment programme, especially the four main capital spending areas—health, justice, transport and further and higher education—although I should mention that we do not cover the performance of local government projects.

The report starts with a description of how the much more restricted public spending environment is likely to affect the capital programme in future. I am sure that that will not come as news to committee members, but it might helpful if we remind ourselves of the numbers in the capital programme. In the first 10 years after devolution, the capital budget increased by 41 per cent; however, between this year and 2014-15, it is likely to reduce by 36 per cent. Perhaps that is best illustrated in the first exhibit on page 2 of the key messages summary, which clearly shows the trend since devolution.

At the same time, the Scottish Government has a number of projects that are legally committed. The second exhibit on page 2, outlines both the level of contractually committed projects—in other words, the projects that you cannot really get out of—which stands at £2.1 billion, and the level of planned projects that are not yet contractually committed, which amounts to about £5.4 billion. Projects in that second category will be at different stages, but they are not yet fully committed legally.

As I said, the report relates to the four main capital spending areas that I listed a moment ago and covers the next four years.

On page 10 of the main report, we summarise the largest projects in progress as at December 2010, and exhibit 4 on the same page sets out a list of projects costing more than £300 million.

It is clear that difficult choices will need to be made to bring the budget into line with the lower level of resources projected for the future. I emphasise that those choices are not only between new projects. Despite the big spending increases in the past 10 years, we have, as we have already reported to the committee, estimated that the backlog in the maintenance of our current stock of existing assets is more than £4 billion. Although there are plans that will address some of that backlog, it must be fully recognised and taken into account in deciding on future priorities. Putting it starkly, I say to members that, if we do not provide adequately for maintaining our physical assets, we will pass the burden of a crumbling estate on to future generations.

A related issue is the need to make adequate provision in annual revenue budgets for depreciation, general maintenance and on-going repairs and running costs, which tend to come out of revenue rather than capital budgets. However, for what might be called traditionally financed assets in the capital programme, there is no comprehensive information on these costs, which means that we cannot assess the impact on future revenue budgets. That should certainly be taken into account in budget planning as resources become more constrained.

In the report, we recognise that a range of financing methods can be used to supplement the capital budget, and the various methods of financing capital investment and the advantages and disadvantages of using private finance are described in exhibits 7 and 8 on pages 13 to 15 of the main report. These methods are important. Since devolution, revenue-financed schemes have provided about £4.8 billion of infrastructure projects in Scotland, which is the equivalent of an extra 20 per cent a year on top of the traditional financing for projects.

In the current year, 2010-11, the Scottish Government and public bodies will make annual payments of about £838 million for revenue-financed projects—in other words, private finance initiative and non-profit-distributing-type schemes. We estimate that those payments will peak at more than £1.1 billion in cash terms in 2024-25. If, as expected, overall budgets reduce, the proportion of available resources going into those unitary payments will increase—after all, they are unavoidable—and that will add to pressure on available resources.

In the second part of the report, we examine the performance management of recently completed projects. I am pleased to report that the accuracy of cost estimating for what we call traditionally financed projects—in other words, those paid out of the Scottish budget—has improved in recent years. For example, from our survey of projects, we found that just short of 60 per cent were completed within initial estimates, which is a distinct improvement on the performance that we found in 2008. Also, most projects—about 86 per cent—were completed within contract award estimates, which again shows a significant improvement compared with 2008. The accuracy of cost estimating for revenue-finance projects—which are, as I have said, PFI and NPD-type projects—was similar to that for traditionally financed projects, but we cannot say whether the situation has improved as this is the first time that we have looked at that area of the budget.

Overall, those results are encouraging. However, my report also highlights some significant gaps in the availability of information to measure whether projects have been completed within budget and on time. The greatest gap was information at the initial approval stage. For over 20 per cent of the 55 projects, the project owners—the people responsible for commissioning a project—could not provide a cost estimate at that stage,

The use of evaluations after projects have been completed has improved but the level of coverage and form of evaluations vary across most spending areas. The Scottish Government is working to produce a standard post-project evaluation programme that it intends to apply to all spending areas and project types at some point in the future.

The report recommends that public bodies should report more systematically on their current and future capital investment plans, and to do so they need better performance information. I am pleased to report that the Scottish Government has recently developed an infrastructure projects database to record centrally information about on-going projects.

The report indicates that the Scottish Government has improved its leadership and oversight of the capital investment programme. For example, an infrastructure investment board was created towards the end of last year, which is supported by the database that I just mentioned. All that should help to provide more effective scrutiny of the investment programme in future.

The Scottish Government's infrastructure investment plan for the next 10 years was published only a few years ago, in 2008, but it seems pretty clear that the recession and subsequent reductions in budgets will require it to be reviewed. I suggest in the report that the plan should be widened to become a proper strategy that sets out a clear view for investment in future years, which should be backed by good information about long-term needs, the condition of the public sector estate and what needs to be spent on it, the sources of finance and what is affordable, as well as a clear statement of priorities.

Finally, I mention in the report the scope that exists to strengthen public reporting of projects in progress. The permanent secretary, who is the accountable officer, provides six-monthly reporting to the committee, which is extremely useful—that did not use to happen—but in paragraphs 94 and 95 on page 34 of the main report, I describe the current arrangement and suggest ways in which it could be improved.

As ever, the team and I will answer any questions to the best of our ability.

The Convener: Thank you very much, Mr Black.

I want to clarify some issues of description and nomenclature. Which method did the previous Administration use for the funding of capital projects, in addition to traditional finance?

Mr Black: The previous Administration used the private finance initiative significantly. Exhibit 9 on page 16 of the report highlights how important that was. It describes the capital value of PFI and non-profit-distributing projects since devolution, by sector. Alternatives to PFI have been under development for a number of years. That started under the previous Administration. The team might be able to help with more information about that earlier stage.

Dick Gill (Audit Scotland): I think that you have captured it well; I am not sure that there is much more to say. The NPD initiative was something that came in in the early days of the Scottish National Party Administration.

The Convener: Is it not the case that a couple of NPD models were developed prior to 2007?

Dick Gill: There was a pilot project in the schools sector, which was progressed under the Labour Administration as an experiment. Greater priority was given to NPD under the SNP Administration. Indeed, a policy decision was reached that, in future, it would be the preferred form of finance.

The Convener: The previous Administration described it as PPP. You distinguish between PPP and PFI. What is the difference?

Mr Black: I think that it is fair to say that PPP—public-private partnership—is the umbrella phrase that applies to all such projects. Various non-profit-distributing vehicles and PFI vehicles come under the PPP umbrella and are used as appropriate.

The Convener: So the non-profit-distributing model is essentially still a form of PPP.

Mr Black: Yes, the essence of that model is that there is a profit cap or that, after the financier and the developer have made a return, the profits come back into the public purse.

The Convener: Okay.

I notice that paragraph 28, which is just across the page from some of the descriptions on page 13, mentions some projects for which the initial intention had been to use traditional funding, but for which the present Administration is moving towards the use of PPP. The new sick children's hospital in Edinburgh and the city of Glasgow college will now be funded through PPP. Is that correct?

Dick Gill: Yes.

Mr Black: Yes.

10:15

Murdo Fraser (Mid Scotland and Fife) (Con): I will follow up that line of questioning. Exhibit 7 on page 13 of the report gives the definitions of the different methods of financing. In reference to the non-profit distributing method, it states:

"NPD is a form of PPP."

Would it be fair to say that "non-profit distributing" is a bit of a misnomer? It is not non-profit distributing; it is capped-profit distributing.

Mr Black: That is a reasonable way to refer to it in many ways.

Dick Gill: We have not audited any individual NPD projects, although we have looked at a number of PFI projects in the past. My understanding of NPD contracts is that the company that is formed to provide the services that are required under the contract is unable to distribute profits. The profits are retained and may be applied to public projects, but they are not distributable.

Murdo Fraser: Does that apply to all the profits? There is a suggestion, in the definition, that a certain amount of profit is retained by the funder and it is the surplus profits that are—

Mr Black: Yes. As I commented earlier, the funder clearly requires to make a return on their investment. However, a cap is placed on that and any surplus is returned or shared with the other parties.

Dick Gill: We have tried to use high-level language. There are obviously profits in any project, as any project involves engagement with the private sector. Therefore, a construction company that carries out work under an NPD contract will earn profits from that activity. The point of an NPD arrangement is that it restricts what the special-purpose company that is set up as the focus of the project can do with its profits. It cannot distribute profits to its shareholders—that is the essence of the arrangement.

The Convener: Just let me clarify that again. Murdo Fraser is saying that there will be profits—you have confirmed that—but they will be capped.

Dick Gill: Yes.

The Convener: So, there are profits, but any surplus profits—whether there are any remains to be seen—do not get distributed.

Dick Gill: If it would be helpful, we could provide a note to the committee on that. I am having to use terms such as "special-purpose company" because it is quite a technical area legally and contractually. You have got the gist of it. If you want a bit more specific information, we can provide it.

The Convener: Yes. We just need to get our heads around the fact that the companies that are involved in the projects will still make profits, so it is a form of PPP. Also, just as previously, the public sector will pay an annual charge over the life of the asset—there is no difference there.

Dick Gill: It is exactly the same arrangement.

James Kelly (Glasgow Rutherglen) (Lab): In the period ahead, budgets will be challenged, so it is important that good monitoring arrangements are in place to track money that is due to be spent on capital projects and money that is forecast to be spent in the future. It is a matter of concern that, in paragraph 16 of your key messages report, you state that, in relation to the revenue charges that result from capital investment, you have had difficulty in getting information for some of the projects—especially the traditionally funded projects—regarding on-going revenue costs, which makes forecasting difficult. In the case of depreciation, for example, standard policies are normally applied and, if the initial capital investment is known, it is relatively straightforward to project the depreciation going forward. However, your report underlines the fact that, for certain projects, you have been unable to get on-going information relating to depreciation charges.

Mr Black: That is correct. We could not provide in the report high-level information on those on-going cost requirements of depreciation, running costs and so on. I am sure that the team can provide a bit more detail about the problems that they faced in addressing that issue.

Dick Gill: The issue is about strategic—forgive me for using that word—information that is available to the Government. It is perfectly possible, given enough time and resource, to identify the forecast running costs of an individual project.

In the current programme, there are about 180 projects at various stages of development, and it is a matter of getting aggregated information at a strategic level and determining the financial consequences for the investment programme. That is where our difficulty lies.

James Kelly: I appreciate the challenges that you face as a small audit team, but I am trying to establish what the Government does when it is trying to forecast investment that is to be made. Correct me if I am wrong, but I interpreted paragraph 16 in the key messages report to mean that the information was not available—either from the Government or from—

Dick Gill: That is absolutely correct, and it is one of the reasons why we have suggested that the Government might wish to consider revising or revisiting its infrastructure investment plan, so as to make that a more strategic document. The point that you have highlighted is one of the issues that the Government should be considering.

James Kelly: Okay. I reiterate the importance of having accurate information, and the Government has to take that on board seriously.

Moving on to paragraph 36 in the key messages report, you make a point about how capital projects have been budgeted for over the past three years. I am slightly taken aback by this. From the way that you have described it, the budgeting has been done in such a way that an additional £100 million has been allocated against capital projects, over and above the anticipated spend in each year. I would have thought that the most efficient approach would have been to allocate the budget against the anticipated spend. If there were any project overruns, those could be addressed at the spring or autumn budget review.

We are going through budget discussions now. If we take the retail tax, for example, the Cabinet Secretary for Finance and Sustainable Growth is quite correctly challenging the Opposition parties to say from where the additional £30 million could be found. If the budgeting approach that I have just discussed is being used in 2011-12, there is £100 million of slack, in effect. That is a surprising approach to take when budgets are so tight. Do you have any comments on that?

Mr Black: I can understand the reasoning behind that concern, but it has been very common for years, in managing a large capital programme with many projects, to follow such an approach. I recall from my previous life as the chief executive of Tayside Regional Council, when I chaired the financial planning group, considering the projects that we intended to have in train in any one year. In the course of that year we would almost inevitably encounter slippage somewhere. That is just life when major capital projects are concerned.

In recent years, the Scottish Executive and the Scottish Government have committed on paper slightly more than the resources, in the knowledge that there will almost inevitably be slippage somewhere. That allows the Government to bring in the outturn closer to target and has contributed, to an extent, to the improvement in the Government's outturn performance over the past few years.

Angela Cullen (Audit Scotland): We try to write our reports in plain language, and we have perhaps failed in the paragraph to which Mr Kelly referred. The £100 million of overallocation each year is for revenue and capital—it refers to the whole of the Scottish budget, so there has not been a £100 million overallocation just for capital expenditure. It is intended to allow some flexibility between revenue and capital and, as the Auditor General said, there will inevitably be some slippage, which allows the £32 billion to come in closer to the mark.

James Kelly: How is that reflected in the budget documentation? I do not recall seeing it in any previous budget documents.

Angela Cullen: The purpose of the approach is to help the Government achieve the budget that has been set. These are the Government's spending plans against the budget. You may recall that we picked up on this issue in our report "Scotland's public finances: preparing for the future". More recently, the committee considered the outturn of the Scottish Government's consolidated accounts where subsequent evidence came in on the actual outturns over the 10 years since devolution that showed that, because of the practice we are discussing, the outturn on the overall budget was smaller than it had been in previous years.

James Kelly: I understand your point, but it was certainly news to me that, in effect, £100 million of slack had been allocated. It might have been in the documentation, but I did not pick it up in previous budget documents or in the current budget.

Mr Black: I would not encourage the committee to use the term "slack", because the performance is quite clear: at the year-end, the Government comes in very close to budget. The £100 million is essentially a financial management tool that is used in the Scottish Government to try to ensure that that happens.

Nicol Stephen (Aberdeen South) (LD): Just to be clear on this, are we saying that the Scottish Government budgets to spend £100 million more than the budget and that that is not disclosed in any documents?

Angela Cullen: The recent spending reviews have specifically stated that there would be a £100 million overallocation each year compared with the budget that was being approved. That is just the spending plans.

Nicol Stephen: Yes, I understand. We are talking about spending plans that are budget plans. Is that £100 million disclosed anywhere?

Angela Cullen: It is in the spending plans and, as far as I am aware, it will be in the budget.

Dick Gill: It is included as a description.

Nicol Stephen: In the budget document, do we see a budget figure plus £100 million? How is it described? How do we get transparency, openness and disclosure on this issue?

Jamie Hepburn (Central Scotland) (SNP): You read the budget.

Nicol Stephen: Where is the £100 million allocated?

Angela Cullen: It is in the budget, but it is allocated over hundreds or thousands of individual projects.

Dick Gill: The allocation takes place at a level that I do not think is disclosed in the budget document. Allocation happens at project level and that project investment is not disclosed, because there are hundreds of projects at the same level of detail. It is not disclosed in the budget estimates. So, the budget is the budget and there is no uncertainty about that, but there is a description in the estimates of the financial management process in which the Scottish Government engages to help ensure that it spends as close as possible to its annual budget and does not overspend.

Nicol Stephen: But let us say that the budget is £30 billion, in round terms. Do the budget documents show that the Scottish Government has budgeted for £30 billion plus £100 million?

Dick Gill: No. Because the budget is the budget it shows that the figure is £30 billion, but a kind of disclosure in the budget documents states, in effect, "We have adopted this practice."

Nicol Stephen: If we were to add up the individual budget headings, they would come to £30 billion and £100 million.

Dick Gill: Yes, if they were available. However, they are not available because—

Nicol Stephen: Because they are not disclosed at that level.

Dick Gill: Exactly.

Nicol Stephen: That means that if the Scottish Government chose to budget to £30 billion plus

£130 million, let us say, that would simply be disclosed and regarded as normal practice. Is that right? In other words, the figure of £100 million that the Scottish Government overbudgets is clearly not a magical figure.

Dick Gill: It is a matter of judgment on the Government's part.

Nicol Stephen: Judgment is a good term. It is a judgment whether the figure should be £80 million, £100 million or £200 million, let us say, because of the level of underspend that is generated each year by the Scottish Government, because there has never been an overspend. Is that correct?

10:30

Dick Gill: I do not have the figures to hand, but my recollection is that four or five years ago there was a pattern of the Scottish Government underspending against its budget by of the order of £500 million or £600 million per annum. That was seen to be a poor use of resources, because the Scottish Government was spending less money than it had.

Nicol Stephen: I think that the committee has received those figures.

Dick Gill: Yes, it has.

Nicol Stephen: I do not think that the normal underspend of £500 million to £600 million that you have quoted is accurate. There has always been an underspend and there continues to be an underspend. There was an underspend last year, as I recall. My point is that there has never been an overspend by the Scottish Government. The level of the underspend has varied substantially from year to year over the devolution period. You are saying that the current policy is deliberately to overbudget by £100 million in order to try to ensure that the budget comes out closer to the actual figure, but that is not detailed in the budget documents at a level that would be clear to MSPs and this committee.

Mr Black: As I think that Angela Cullen said a moment ago, the language of this is really difficult.

Nicol Stephen: It is very important.

Mr Black: The budget is the budget, approved by Parliament. However, in managing that budget within Government—with literally hundreds of different projects—the Government will allocate more than the actual budget at the margin, because there is always slippage and projects can always be reined back three quarters of the way through the year once the projected outturn has been done round about January or February for year end. To my mind, that is good financial management.

Nicol Stephen: But, Mr Black, would it not be reasonable—

Mr Black: It is good financial management because it means that you are getting closer to the budget at the year end.

Nicol Stephen: But would it not be reasonable to disclose how that is done and to be transparent about it? I am seeing absolutely no transparency on that issue.

Mr Black: As I think that Dick Gill mentioned, there is disclosure of the general approach in the budget.

Nicol Stephen: I am sorry, but I am talking about understanding how that £100 million is allocated across the budget.

Jamie Hepburn: Convener, would it be helpful—

The Convener: Hold on. I will let James Kelly in and then Anne McLaughlin.

James Kelly: I just want to make the central point that we are going through the budget process at the moment. It is certainly news to me that £100 million more than the actual budget is being allocated.

The Convener: Let me be clear about this. From what I am hearing, in respect of the overall figures that are provided to members, there is a specific figure and the Government seeks to live within that figure. However, at the level of information that is not provided to members, there are budget allocations that, when totalled, come to more than the budget provision.

Mr Black: Yes, by a small margin.

The Convener: By £100 million. So, if you were to add up the figures that we do not see, the budget is £100 million more than what is indicated to members. You are saying that that is good financial management because, in the course of the year, things will even out and the Government will stay within its budget. Is that correct?

Mr Black: The significance of paragraph 36 in the report is not simply to inform the committee of the financial management practice that takes place in year but to make the point that the risk of overspend might be increasing in an era of declining resources. In other words, it needs to be managed very carefully to avoid the risk of breaching the budget limit.

The Convener: Until now, that might be an issue, because when members are considering the budget they do not know that level of detail—that there is an overprovision or an overanticipation. If members are looking at budget headings, they are not able to challenge where the money is being spent because they are simply being told, "Here is the top line", and they do not see the detail. Would I be right in saying that that will become less of an issue in future years because, as we have discussed before in the committee, we are moving to approval of top-line figures rather than detailed scrutiny of departmental figures?

Mr Black: Yes. In essence, the budget act will be based on a single figure, within which the Scottish Government must live, to use your phrase. The Government has given an undertaking that it will not reduce—and will continue to try to improve—the quality of in-year financial reporting that it gives to the Scottish Parliament.

The Convener: However, as James Kelly and Nicol Stephen said, we cannot see that level of detail even now, never mind in the future, because we do not get the breakdown of what is budgeted for individual projects. We will see only the top-line figure.

Anne McLaughlin (Glasgow) (SNP): There seem to be two interpretations of the situation. Mr Black, do you think that it is something shady and underhand, which you need to investigate, or is it a perfectly legitimate and not unique accounting tool to ensure that we reduce the amount of money by which we underspend and therefore reduce the amount of money that goes away from public services in Scotland and back to the United Kingdom Treasury?

The Convener: Before you answer, Mr Black, I want to put it on record that the committee is not suggesting that anything shady or underhand is going on. I would not want anyone to go away with that impression.

Anne McLaughlin: Not the committee, but Nicol Stephen.

The Convener: There is a separate issue about transparency and openness. If Mr Black could answer in that context, that would be helpful.

Mr Black: The practice that has been adopted in recent years by the Scottish Government, of overallocating at the margin within the set budget, has contributed to better financial performance, as measured by the outturn against budget in recent years. That was documented in past reports that have been given to the committee.

The Convener: That is perfectly clear, and it sounds as though it is a worthwhile financial management tool that is worthy of adoption. However, the issue that was being raised was not whether it was a good financial management tool but whether it was effective in terms of accountability and parliamentary scrutiny of the budget process. That is a debate that is best left to the politicians rather than you, Mr Black.

Nicol Stephen: What the convener has just said is absolutely correct. It is an appropriate debate to have. The matter should perhaps not be pursued at this point, but it is something that, as politicians and as a Parliament, we might consider pursuing. Someone suggested that £100 million is a small amount of money. However, in the context of some of the debates that we have had since devolution, £100 million is a substantial amount of money. In the context of the debate that James Kelly is talking about, for example, £30 million is a significant sum of money. Further, in the debates around tuition fees in which the Liberal Democrats and Labour were engaged in 1999, we were talking about sums of money that were substantially less than £100 million.

The Convener: Does James Kelly want to raise anything else?

James Kelly: No, I have covered my points.

The Convener: Anne McLaughlin?

Anne McLaughlin: I might be misunderstanding what Nicol Stephen is saying. Is it the case that there is an extra £100 million floating about that could be spent on the things that Nicol Stephen is talking about? I do not think that £100 million is an insubstantial sum. Is there £100 million floating about that we are not using?

Mr Black: No.

Jamie Hepburn: To further clarify that point, is that £100 million included in the headline figures in this area of the budget?

Angela Cullen: No.

Mr Black: The budget figure is the budget figure. Once the budget figure has been set, the Government manages the programme by overallocating in certain areas in anticipation that there will be slippage and that—

Jamie Hepburn: I understand that. It was not clear to me whether it was in the headline figure.

Mr Black: There is no sum of £100 million concealed anywhere.

Jamie Hepburn: Murdo Fraser invited Mr Gill to accept the definition of NPD as a capped-profit-distribution model. In that regard, would it be fair to characterise PFI as an uncapped or unrestricted-profit-distributing model?

Dick Gill: I cannot think of any way in which it might be restricted, other than by the contract that is entered into with the Government, as it would depend—

Mr Black: An indirect answer to Mr Hepburn's question would be that PFI contracts are usually struck after a competitive process.

Dick Gill: Yes, I mean—

The Convener: After that competitive process, will the revenues be restricted to what has been contractually signed?

Dick Gill: Yes, in essence there will be a fixed price for the contract. That will be agreed in advance, so in that sense there is a cap, in that you would expect to continue to pay the contract sum over the lifetime of the contract. What is not capped is any element of profit that the private firm may derive from its activity over the 30-year contract.

Jamie Hepburn: Can you think of any PFI contracts—as opposed to NPD projects, when it is part of the model—in which some of the money is reinvested back into the public sector?

Dick Gill: We have not looked at any PFI projects in that way as part of this project. A couple of NPD projects have been completed in the schools sector, but even those would have been running for no more than three or four years and they have a 25 or 30-year contract life, so the idea of reinvesting profits at the end of the contract has not yet arisen.

The Convener: So we do not know that, in any NPD contract, money will be reinvested back into the public sector. It is too early to say; it might happen, but it might not.

Mr Black: We do not have any evidence because, as I am sure you appreciate, the report is looking at the management of the capital programme rather than the use of finance.

Nicol Stephen: Exhibit 9, on page 16 of the main document, shows the total capital value of PFI and NPD projects. The schools spend is the part of the bar that is coloured blue. There is a very substantial level of spend in 2005-06, 2006-07 and 2007-08; the figure is around £500 million in 2005-06, and it rises to almost £1 billion in 2006-07 and 2007-08. However, it collapses to under £100 million in 2008-09 and seems to disappear completely in 2009-10.

What is going on? Has there been any compensating expansion of expenditure on schools capital programmes and new schools through traditional funding methods, or has spending on new schools ground to a halt?

Mr Black: I will invite Dick Gill to come in shortly and explain the movement to the best of our ability.

However, I draw your attention to exhibit 3, on page 9 of the main document, which summarises the capital budget in 2010-11 and 2011-12. The line for local government, which is the third line down, indicates that the capital budget for 2010-11 is £843 million, while for 2011-12 it is £692 million. That money is grant aided by the Scottish Government to local government and I suspect that it is principally, possibly exclusively, for the education programme.

Dick Gill: I do not think that it is exclusively for the education programme.

Mr Black: But a large part of it is for the education programme.

Dick Gill: Yes.

To try to give a complete picture, I will highlight exhibit 4. Exhibit 4 highlights all projects in progress that are under way, including projects at planning stage. The second item in that exhibit is the schools for the future programme, which has an estimated investment value of £1.25 billion. That is very much a forward-looking programme and its estimated completion date is 2017-18.

10:45

Nicol Stephen: Did you say exhibit 4?

Dick Gill: Yes. It is the second item in the table on page 10.

We have not given an exhibit that profiles that £1.25 billion investment, but if you were to visualise it in terms of exhibit 9 on page 16, you would see an equivalent peaking of investment somewhere off to the right, which would reflect the plan for the schools for the future programme.

Nicol Stephen: Is that a PFI or NPD programme?

Dick Gill: It is a mixture of traditional finance and NPD. It is also a mixture of finance from the Scottish Government and the local government sector. Note 1 on exhibit 4 says:

> "The Scottish Government is providing £800 million towards the £1.25 billion required for the Scottish school building programme".

I understand that the initial spending requirement for that programme will be found from within the traditional budget, although I think that the Scottish Government is talking about using NPD later in the programme to contribute to that spending commitment.

Nicol Stephen: Is that for the future?

Dick Gill: It is, yes.

Nicol Stephen: My question is about exhibit 9.

Dick Gill: I am trying to say that the investment has gone in cycles and that what you see in exhibit 9 is a significant cycle of investment in the schools programme. Exhibit 4 suggests that another significant investment cycle will be coming up during the next six or seven years.

The Convener: Will the £800 million be spent over the six or seven years, or is it for each year?

Dick Gill: I am afraid that I do not have a profile of the spend with me.

The Convener: Is £800 million the total?

Dick Gill: It is, yes.

Mr Black: I do not wish to mislead the committee but, if I recall correctly, I think that I indicated that the sum on that line in exhibit 3 is for schools only. I apologise for that. Clearly, it will include other things such as major waste management schemes and other projects.

The Convener: You were talking about a period of six or seven years.

Dick Gill: Yes.

The Convener: Over that period, and being generous, an average of £150 million a year will be spent. It looks as though well in excess of that sum was spent in the years 2004 to 2007.

Dick Gill: The schools for the future programme has a £1.25 billion investment programme. It is spread over six or seven years, so that would be approximately £200 million per year.

The Convener: I am talking about the Scottish Government's contribution. Is what we see in exhibit 9 the total spend on each of the heads, or is it the Scottish Government's contribution?

Dick Gill: We are comparing two slightly different things. Forgive me; that is possibly my fault for introducing the idea. Exhibit 9 deals with NPD investment, so the £1.25 billion is likely to be a mixture of NPD and traditional finance. The situation is further complicated because some of the finance will come from the Scottish Government's capital budget, and some will come from local government's capital budget.

Nicol Stephen: There seems to have been more than £2 billion spent on schools in the three years 2005-06, 2006-07 and 2007-08. Is that figure correct?

Dick Gill: It is something of that order, yes.

Nicol Stephen: If my reading of the exhibit is correct, it looks as though the figure is substantially more than £2 billion. In three years, £2 billion was spent. In the following two years, less than £100 million was spent. You are saying that in the next six to seven years, perhaps £1.25 billion will be spent on schools.

Dick Gill: Yes.

Nicol Stephen: Thank you.

Murdo Fraser: I want to ask about some of the findings in part 2 of the report, which covers the performance of recently completed major capital projects. In previous meetings, over a long time, the committee has looked at the fairly dismal record that we have on cost and time overruns in capital projects. Indeed, if we are to believe what we have heard this morning from the BBC, your report on the Edinburgh trams, which is due to be published, suggests a similarly dismal picture—although I dare say that you will not want to comment on that until the report is published.

I am keen to get an understanding of whether we can detect any difference in the delays that occur when projects are funded in the traditional manner, under PPP or in whatever way. I do not get a clear answer from reading the report, which suggests that how a project is financed does not make much difference to the delays that are experienced, but I would welcome further elaboration on that.

Angela Cullen: I will kick off, and Dick Gill and Kirsty Whyte can chip in. We highlight the fact that there were significant gaps in the information that was available to us during our review, so it involves a smaller sample than the 35 projects that were completed up to 2010. We found no difference in performance in meeting cost and time estimates between traditionally financed projects and revenue-financed projects—or they were very similar in performance.

Murdo Fraser: A lot of the time delays that are noted in the report tended to occur at a very early stage. Do a lot of time delays occur before the decision is made about how a project is to be funded?

Dick Gill: That is a fair comment. In exhibit 14, on page 24 of the report—it is the upper exhibit—we have marked with an asterisk those projects that were revenue financed. In the section for projects in the health sector, which is towards the right-hand side of the exhibit, there are significant differences between the forecast and actual completion periods. A lot of those differences are associated with revenue-financed projects. A feature of revenue finance is that it is a complex process that involves constructing contracts with a 30-year life, which introduces all sorts of complexity and challenge into the commercial arrangements. That means that it can take a long time to get it all sorted out. Some of those projects that became revenue-financed projects may have been originally designed to be progressed as capital-financed projects but the capital budget was not sufficient to allow that. Different financing methods had to be investigated, which took time, and there was slippage in the overall completion periods for the projects.

Murdo Fraser: That is helpful. That deals with time delays. Can we move on to the cost estimate comparisons in exhibit 13, which, I confess, I had difficulty in deciphering?

Dick Gill: It is quite complicated.

Mr Frank McAveety (Glasgow Shettleston) (Lab): It looks like a game of battleships.

Murdo Fraser: Can you talk us through what that graphic tells us?

Mr McAveety: Whatever you want it to.

Dick Gill: I will start. We compare the cost estimates at two different points, which are the two benchmarks that we think should be used. The first is the point at which the project is first approved and reaches the outline business case stage; the second is around the contract stage. The first estimate is important because, when a project is started, a realistic assessment of what it is going to cost the public sector is required. That is important for appraisal and strategic decisions about choices between projects. The estimate at the contract stage is important because, if that estimate is not achieved, there is every possibility of inefficiency and waste going on—it is an indicator of poor management of the project. We looked at both those measures.

For traditionally financed projects, we looked at the outturn compared to those estimates. Revenue-financed projects proceed over a 25 or 30-year period, so we do not know what the outturn cost of the contract will be until the end of the contract. Therefore, we used as a third measure the forecast service payment at the financial close—in essence, the latest estimate of what the contract will cost over its life.

If you look at projects 32 and 34, you will see that there is a huge difference between the forecast service payments at initial approval, the later estimates and the latest estimate of the total lifetime costs, but the difference is in the right direction. The costs did not increase; they reduced significantly. What happened is that the accounting for the estimates changed radically between the time periods in question. The forecast service payments at initial approval were calculated on a different basis from the subsequent estimates—essentially, there is an accounting difference.

That is one reason why we have highlighted the gaps in project information. We could not get good information on costs without a great deal of effort—I am sure that Kirsty Whyte will tell you more about that if you have a few hours to spare one evening—because there is no standard way of recording, monitoring and reporting on costs. We had to do that work using our methodology, and it has thrown up the challenges that I mentioned. However, the good news is that there is little indication of any significant cost increases. One of the projects incurred a significant cost increase, which we explain in note 4 on exhibit 13, but we cannot see any systematic pattern of overestimating or underestimating in the projects.

Murdo Fraser: And that applies regardless of how the project was funded.

Dick Gill: Yes. The projects in exhibit 13 are exclusively revenue-financed projects. The equivalent data for traditionally financed projects are in exhibit 11. If you wish, I can provide some commentary on that but, essentially, the cost estimating is improving compared with the position that we reported in our 2008 report.

Angela Cullen: If it helps, I will give a quick summary of exhibit 11. We appreciate that it is quite hard to digest. Sixty per cent of projects were within the initial cost estimates and 40 per cent were not, but 86 per cent came in within the contract price that was signed and only four projects did not. The combined total cost that was paid out was less than the contract price that was signed for all those projects.

Dick Gill: Both the statistics that Angela Cullen mentioned are significantly better than the equivalent statistics that we reported for the earlier set of projects in our 2008 report. In our current report, 60 per cent of projects completed within the initial cost estimates, whereas it was just 40 per cent in the previous report. Eighty-six per cent of projects completed within the project approval price in the current report, but it was just 58 per cent last time round. There is quite strong empirical evidence that estimating is improving.

Murdo Fraser: Okay. I think I understand most of that. Thank you.

Anne McLaughlin: Your report recommends that

“post-project evaluations are completed for every major capital project and lessons learned are shared across all relevant public bodies.”

That is one of the recurring themes on this committee and we all agree that it is incredibly important. You also state that the public bodies should

“carry out post-project evaluations within six months of project completion”.

You state on page 18:

“post-project evaluations are required by the Scottish Public Finance Manual. However, their completion remains variable. Only 40 out of 55 recent projects had completed or were planning to undertake post-project evaluations”.

That means that 15 of them had no plans to do so despite the requirement in the “Scottish Public Finance Manual”. How much of a requirement is it, and who compels them to do it? Should it be the Scottish Government that ensures that it happens, and how can it do that? What compulsion is there to ensure that it happens?

11:00

Dick Gill: I think that everybody recognises that these things should be done, but somehow they do not always get done. Again, the position is improving compared with the position in the 2008 report—we have statistics on that—but one of the difficulties that the Government has had is getting good information because of the sheer number of projects.

Elsewhere in the report—colleagues might be able to help me with the reference—we talk about the Government's new infrastructure projects database, which is intended to be a comprehensive catalogue of all the projects that are under way at any point in time. That is a new development, which the Government has brought into operation in the past few months; indeed, I think that it is still populating some information.

Among the key pieces of information on that database will be information about which projects have had a post-project evaluation, which have not and what the results were. For the first time, the Government will be able to say more or less at the click of a button what has had a PPE and what has not. That will be quite a big step forward, and it should allow much more active policing. If representatives of the Scottish Government were here, I think that they would say that they really wanted that to happen. They see that it is important. However, it is a question of compliance, and I am afraid that not everybody complies with the rules.

The Convener: I have a couple of questions to round off the discussion. Do you know why the Government is moving from traditional funding to public-private partnerships for the city of Glasgow college and the Royal hospital for sick children in Edinburgh?

Mr Black: The short answer is no. We did not look at individual schemes in detail and we did not look at the financing. The report is simply a high-level report. I am sorry.

The Convener: Okay.

Have you done any work on comparing whole-life costs under different funding models? For example, have you considered the cost of building, running and maintaining facilities under the traditional method, subtracted the asset value at the end of a fixed period, and compared that with the cost of a PPP project over 30 years and the value of the asset at the end of those 30 years? Have any comparisons been done?

Dick Gill: We have not done that as part of an audit, but the consideration of delivery options would be essential as part of the appraisal process for any project. For a revenue-financed project, one would certainly want to compare the estimated costs using that model and the whole-life costs using another form of finance. That is a standard part of an investment appraisal.

Angela Cullen: We say in the report that the information on whole-life costs for traditionally financed projects is not completely available, so comparisons would be quite difficult.

The Convener: Yes, it is difficult to make comparisons. When people criticise a model, it is difficult to make a valid comparison with another model.

Dick Gill: That can be done at the project level, but our difficulty is at the programme level. Such information cannot be extracted without going to individual projects. With hundreds of projects, we were not able to do that.

The Convener: Finally, you have outlined that there are a number of very good management proposals relating to the control of costs and reporting, for example, but I am worried about the future of capital investment that you have highlighted, irrespective of who will form the next Administration after this year's election. It is quite clear that there are major, hugely expensive projects in the pipeline. You have indicated to us graphically the significant reduction in the availability of capital and you have highlighted at various points the reduction in revenue. Previously, you have reported to us on the pressures on the maintenance of roads and the school estate, universities and a range of other things that are not referred to in the report. I am worried about the point at which either you will give a reality check to politicians or there will be a debate on what we can realistically afford.

Perhaps we need to wait until after the election, but Audit Scotland has highlighted here and elsewhere a sobering picture of what is in front of us.

Mr Black: Yes. I am afraid that it is quite often my humble duty to tell members when the glass is half empty, and this is one of those occasions.

The issue is serious. Towards the end of the report, we make a significant and perhaps challenging recommendation for the Scottish Government under any Administration after the election. That recommendation is to take the framework of the infrastructure investment plan and build it up into a full strategy that considers long-term investment needs and the resources that are available, and builds in important factors such as the condition of the current physical estate and the need for its maintenance and repair so that the entire existing and planned capital stock is looked at in totality.

The Convener: Thank you very much. On that note, we will conclude the discussion. I thank the

Auditor General and his team for the information that they have provided.

11:06

Meeting continued in private until 12:30.

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