



The Scottish Parliament
Pàrlamaid na h-Alba

Official Report

PUBLIC AUDIT COMMITTEE

Wednesday 24 October 2012

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PUBLIC AUDIT COMMITTEE
14th Meeting 2012, Session 4

CONVENER

*Iain Gray (East Lothian) (Lab)

DEPUTY CONVENER

*Mary Scanlon (Highlands and Islands) (Con)

COMMITTEE MEMBERS

*Colin Beattie (Midlothian North and Musselburgh) (SNP)

*Willie Coffey (Kilmarnock and Irvine Valley) (SNP)

*James Dornan (Glasgow Cathcart) (SNP)

*Mark Griffin (Central Scotland) (Lab)

*Colin Keir (Edinburgh Western) (SNP)

*Tavish Scott (Shetland Islands) (LD)

*Sandra White (Glasgow Kelvin) (SNP)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Sheenagh Adams (Registers of Scotland)

Iain Campbell (Registers of Scotland)

Caroline Gardner (Auditor General for Scotland)

Graeme Greenhill (Audit Scotland)

Catriona Hardman (Registers of Scotland)

John King (Registers of Scotland)

Ronnie Nicol (Audit Scotland)

CLERK TO THE COMMITTEE

Jane Williams

LOCATION

Committee Room 5

Scottish Parliament

Public Audit Committee

Wednesday 24 October 2012

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

Decision on Taking Business in Private

The Convener (Iain Gray): Let us make a start. This is the 14th meeting of the Public Audit Committee this year. I welcome committee members, any members of the public and press who are here, and our witnesses, whom I will come to in just a moment. I ask everyone to make sure that their phones are switched off. We have received no apologies this morning; all committee members are here.

Agenda item 1 is a decision on whether to take items 4 and 5 in private, to allow us to decide how to take forward the evidence that we hear in our public session this morning. Do members agree to take items 4 and 5 in private?

Members *indicated agreement.*

Section 23 Reports

“Managing ICT contracts”

The Convener: Item 2, the first substantive item on our agenda, is to take further evidence on the section 23 report “Managing ICT contracts”. I welcome from Registers of Scotland Sheenagh Adams, keeper of the registers of Scotland; Catriona Hardman, deputy keeper and accountable officer; Iain Campbell, chief information officer; and John King, registration director.

I think that I am right in saying that Ms Adams does not want to make an opening statement.

Sheenagh Adams (Registers of Scotland): That is right, convener.

The Convener: I will kick things off, then. We asked Registers of Scotland to give evidence to the committee as a result of the Audit Scotland report, which looked at information and communication technology contracts in the public sector. It looked at three contracts in particular, one of which was the Registers of Scotland contract. The committee was very keen to hear from Registers of Scotland some of what had happened and to look forward and see what lessons had been learned.

We picked on Registers of Scotland because the figure involved was the highest of the three contracts. Audit Scotland looked at the strategic partnership agreement that Registers of Scotland had with BT. Initially it was expected to cost £66 million over a period of years, but in the end it cost around £113 million—almost twice as much. Despite that initial cost, the contract proved itself incapable of providing the service that Registers of Scotland required. Indeed, it ended up with the termination of the contract 20 months early and the adoption of a different strategy.

I will kick things off by asking generally what Registers of Scotland feels went wrong and why so much money was spent on a project that ended up unable to deliver what it was supposed to.

Sheenagh Adams: Our view is that the partnership agreement was probably always the wrong type of contract for Registers of Scotland because it put all the eggs in one basket with one supplier. The contract was for literally everything to do with information technology and telephony, and it was for a very long period of time.

Although we are a reasonably big public sector organisation—at the time we entered into the contract, we had about 1,400 staff, which is now down to about 1,000—compared with our supplier, we are a very small organisation.

Clearly, there were governance issues. That was partly due to the fact that governance arrangements were provided for in the contract and tied BT and ROS firmly together. In some ways, that meant that the ROS board and the ROS management team did not have a clear line of sight to the overall contract.

The contract was designed in such a way that the intelligent client function sat with the supplier rather than with the public sector body, which meant that ROS did not have the in-house skills to challenge the supplier and make sure that what was being proposed was fit for our business needs.

It was always intended that the contract would cost more than the initial estimated sum. At 2012 price levels, the initial cost estimate was around £78 million—that figure is mentioned in the Audit Scotland report. Up to 1 April, £112 million has been spent. With such a long contract, it is not possible to envisage at the beginning what will need to be spent.

The overall assessment of the contract would be that some of it has worked. BT has provided our basic services right across the board in IT and telephony over the eight years of the contract. BT will now leave on 30 November; we have brought forward the termination date. Services have continued to run, we have had a desktop refresh, and we have delivered our automated registration of title to land project and several other successful projects.

Only two projects did not come to successful fruition. One was the e-settle project; the other was the content management system. Both projects, which were in Audit Scotland's section 22 report, were cancelled. The e-settle project would have required considerably more investment to get it to a usable level and it was not capable of being updated to meet the changes that, by that time, we knew were coming in as a consequence of the Land Registration etc (Scotland) Act 2012. We cancelled the content management system on value-for-money grounds.

In summary, we think that the contract was the wrong approach. None of the current management team was in post in ROS in 2004 when the contract was signed. Obviously, we have the benefit of hindsight—I am sure that our predecessors thought that they were doing the right thing. However, our assessment is that the contract was not the right thing, as both ROS and BT were looking for different things from the partnership.

The Convener: You mentioned size, which is an interesting point. The Audit Scotland report looked at different ICT contracts. You are right to say that Registers of Scotland is by far the biggest

of the public bodies that were audited. Audit Scotland clearly thought that most public bodies were too small to have the expertise needed to procure such a contract. I think that you are saying that even Registers of Scotland, which is at the big end of the scale, found that quite difficult.

A way round that for the public sector is for outside support to come from the Scottish Government. How is it that problems with the strategic partnership agreement could develop over 10 years but there was no support from the Scottish Government to resolve them? Did Registers of Scotland ask for help? Was that help made available?

Sheenagh Adams: We asked for help when we were developing our automated registration of title to land project. The project was running late, and we sought advice from the Scottish Government about how best to handle discussions with BT. It gave us helpful advice on how to escalate issues in the BT hierarchy. Obviously, ARTL was delivered and it is functioning and being used by customers, but that was the only part of the contract that had a built-in late delivery payment clause. We levied a late delivery payment on BT of almost £1 million. The Scottish Government was helpful in that process.

We also had help from the Scottish Government on doing post-project reviews of the two cancelled projects—e-settle and the content management system. Iain Campbell and Catriona Hardman are working with Scottish Government colleagues to develop the central Government digital strategy.

The Convener: There is a sense in the Audit Scotland report that there was little support either during the procurement process and in the early stages or throughout the course of the partnership agreement. Is that not the case?

Sheenagh Adams: Our understanding is that Registers of Scotland received external support on the procurement and on deciding what kind of partnership arrangement to go for. Financial advice was provided by Grant Thornton which, funnily enough, was our external auditor until recently. Deloitte provided advice on strategic matters, and Pinsent Masons—which was McGrigors—advised on legal matters. Clearly, there was a lot of external input.

It is not clear to me what discussions there may have been with Scottish Government colleagues. Registers of Scotland is a non-ministerial department. We are not part of the Scottish Government; we are part of the Scottish Administration. We now work closely with Government colleagues and we shared the lessons learned from our experiences with the Government back in May 2011.

The Convener: You said that the ROS board at the time—I appreciate that you and the other witnesses were not part of the senior management team or the board then—did not have oversight of the project. Are you saying that nobody had that within the organisation? Was there not some kind of project board or partnership board, or some internal body that had responsibility for the project?

Sheenagh Adams: It was structured within the contract. There was a partnership and change group, which was made up of Registers of Scotland and BT staff and took day-to-day responsibility. Things then had to be escalated to a partnership board, which again was made up jointly of Registers of Scotland and BT staff and which the keeper chaired. I have chaired it since I became the keeper. However, there was little visibility up to the main Registers of Scotland board. In addition, no delegated budgeting was in place at the time in Registers of Scotland and, because projects were running behind time, the information coming to the board was that we were underspending on the contract, not that things were escalating and not being delivered.

Obviously, there were reports on particular projects. Certainly, until about 2009 the focus was on ARTL. Once that was delivered, e-settle came to the fore. It was only when we were very much into e-settle and it was into its test phase that it became clear that it was not going to deliver what we needed.

The Convener: There is a suggestion in the submission that you helpfully provided for the committee that the project board was bypassed and that issues came straight to the organisation's main board.

Sheenagh Adams: Not to the main board; they would have gone up to the partnership and change group and, to an extent, to the partnership board and different groupings. Catriona Hardman led a review of governance to learn the lessons of the past. We brought in new arrangements that are now operating and which will cover all projects, whether they be IT-related or business-related projects, once BT has departed.

The Convener: It would be helpful to hear a bit about that.

Catriona Hardman (Registers of Scotland): We started to put changes in place to improve governance in the partnership as long ago as 2010, once e-settle was halted. Over the past two years, we have had much better project planning, execution and oversight. That has been helped by building up our own IT expertise, which clearly makes the process much more effective.

As Sheenagh Adams has said, there is now much better financial transparency in projects and,

most important, there is much better oversight by the board and senior managers. In the past, ROS expected innovative IT to give us business benefits, but we have realised that that was the wrong approach and that IT must align with ROS's strategic aims, and now the board and senior managers have regular oversight of the IT programme. As Sheenagh said, governance of IT projects now escalates via me, as the accountable officer, to the board.

It is also worth noting that, in the past two years, we have developed a key risk register that is looked at by senior managers and ROS's board on a monthly basis and which includes all our IT risks going forward. For example, we monitor in the register the transition back to ROS, and we will add in risks that relate to all our future programme of work.

Mary Scanlon (Highlands and Islands) (Con): What is your view of the Audit Scotland report? Do you think that it is fair and accurate?

10:15

Sheenagh Adams: I welcome what I think is a fair and accurate report. We expressed concern to Audit Scotland about its scope because we felt that it would have been helpful to the committee and the wider public sector had it looked at a broader range of IT relationships and contracts and found examples of good practice to show people what such practice might look like. However, we think that, as it is, the report is useful.

Mary Scanlon: Personally, I think that what we have found is very worrying, particularly given your future tax-collecting responsibilities. Do you agree that the higher collection costs are and the more money is written off on IT contracts, the less revenue Governments have to spend on essential public services?

Sheenagh Adams: Of course, we want to—and will—avoid wasting money. Indeed, I can give the committee a very good example of where we have avoided such waste. We took on responsibility for the crofting register outwith the scope of the strategic partnership agreement. Having failed to reach agreement with BT, which said that developing the register would cost in the region of £1 million to £2 million, we went out to tender and have delivered the crofting register ahead of schedule—it goes live on 30 November—for £600,000. That has resulted in a considerable saving for the Scottish Government, which has been funding the development.

Mary Scanlon: Is it a considerable saving against tens of millions of pounds of loss?

Sheenagh Adams: I am sorry, but it is not tens of millions of pounds of loss. The two projects that were written off totalled less than £7 million. Obviously, the money that has been spent overall has kept our IT services, the phones and everything else running for eight years.

Mary Scanlon: Before I come to my substantive question, I wonder whether you can tell me the level of compensation for BT. The report says that the figure is being negotiated. How much taxpayers' money will BT receive in compensation?

Sheenagh Adams: We will be paying all the inescapable costs that we are contractually liable to pay. Some of that will be in relation to the Transfer of Undertakings (Protection of Employment) Regulations 2006, some to third-party contracts and some to the so-called compensation element. We have made provision for a total of £2 million in our current accounts, which have just been laid before Parliament, but we expect the figure to be less than that.

Mary Scanlon: Another £2 million, then.

As the report makes clear, two projects have been cancelled; the Scottish Government was unable to provide all the advice and support that was sought; the business case and benefits "were not clearly defined"; the

"Governance arrangements were not effective";

there were "weaknesses in financial control"; there were "insufficient in-house" specialist "skills and experience" to deliver ICT; the "Government provided limited support"; there was a six-year gap between the reviews to highlight and address any difficulties; there were 400 changes; and, according to paragraph 70 of the report,

"there is currently no mechanism to ensure that"

lessons are passed on. Among the reasons that we asked you to come to the committee were the scale of the losses and the fact that you are going to be a tax collector. When I came along today, I was hoping to hear a bit more about how you were addressing these points but, as soon as the convener asked his first question, all we got was that it was BT's fault. Given that BT has no right of reply, I am concerned about the comment cited in paragraph 16 on page 4 of your own submission that

"a 'partnership' contract is extremely difficult to make work in an environment where the two parties have fundamentally different motivations. BT is there to maximise profit, while RoS wants a good service at a reasonable price."

That is a very critical point to make about a major organisation that has no right of reply to this committee.

Prior to that, you say:

"the Partnership arrangement was fundamentally unsuitable for a public body."

This and any other Government will work with the private sector. Instead of giving me confidence that you have learned the lessons and are now moving forward, you sound as if you are simply blaming all these issues and problems on a private company that has no right of reply. Is that fair?

Sheenagh Adams: It would not be fair and it is not what I have done. I have not said that I blamed BT; instead, I said that I thought the contract to be inappropriate in scale and extent. We work in partnership with a whole range of bodies, but it was wrong for ROS to go with a single supplier for everything for such a long period of time with a contract that did little to ensure speedy delivery or good value for money.

The comments about the different motivations in partnerships came from Gartner, which is an international consultancy that is regarded as a world expert on such matters. That was its assessment of the matter, not mine—although I do not disagree with it.

We have learned our lessons from this. As Catriona Hardman has made clear, we have introduced new governance arrangements; we have firm delegated budgeting right across the business; and we have brought in our own experts in the shape of Iain Campbell and his team.

As far as tax collection is concerned, we are already collecting stamp duty land tax for Her Majesty's Revenue and Customs. That arrangement has worked well; indeed, it uses our automated registration of title to land service, which was one of the partnership's successful results. I think that we can assure the committee about what we have been doing.

I will ask my colleague Iain Campbell to comment on the number of change control notices, which you referred to.

Iain Campbell (Registers of Scotland): I think that at the previous meeting Iain Gray pointed out that the figure of 400 was mentioned in the Audit Scotland report because it was highlighted in one of our internal audit reports. That number is not helpful; it does not indicate anything in any material sense. Indeed, at the previous meeting, the Auditor General and one of her colleagues pointed out that the number refers to change control notices. The contract bound Registers of Scotland to use a change control mechanism for essentially any change, barring such trivial issues as forgotten passwords and the like. For the avoidance of doubt, I point out that the change control notice did not change the nature of the contract, except in a handful of instances. In 99.99 per cent of cases—396 of the 400, let us say—the mechanism was used for small changes and

modifications to, for example, locations of equipment and the system's behaviour, small upgrades, improvements in usability, changes as a result of changes to legislation such as fee orders, and the buying of new equipment. Given that every single one of what are actually normal activities in an organisation were covered by a CCN, that number is of no use to us in measuring adequacy or problems in the relationship.

Having read the internal audit reports of our previous exercise, I feel that the number was brought up to illustrate the clumsiness of the operation of the change control notice system. Our organisation was suffering because of the administrative load and general eviscerating effect of having to generate one of these notices for relatively minor elements of our day-to-day existence. Internally, we were not happy with that aspect, and I think that that number was used because it projected into the minds of readers in the organisation the amount of hassle and effort required—the treacle, if you like, through which the organisation had to wade—to get anything done. That is what that number indicates, and some of the interpretations that were made of it at the previous meeting were not helpful.

Mary Scanlon: We can only read from what is in the Audit Scotland report. I asked whether you thought the report was fair and accurate, and Ms Adams said that it was. We are not experts; we scrutinise what Audit Scotland says and how taxpayers' money has been spent—and, indeed, wasted.

This will have to be my final question, because I know that many members want to come in. I still feel that you are blaming your partner in the contract unduly. You were an equal partner in signing and agreeing to the terms and conditions of that contract; even if you discovered five or 10 years down the line that it did not suit you, it was still equally your contract. Is it right, fair or justified for you to blame a contract that you fully, openly, honestly and transparently agreed to with BT? Is it fair, if the contract does not work out in your favour, to blame a contract that you agreed to, and indeed to blame a company that has no right of reply here today?

Iain Campbell: The keeper has made it patently clear that we are not blaming BT. You asked whether it would be fair to do that. It would be unfair were we doing that, but we are not.

Mary Scanlon: It is quoted.

Iain Campbell: Yes. The submission is quoting Gartner, the consultancy, which came to the conclusion that the alignment was not good, as BT's interests did not match those of ROS in a way that would produce value for money. It is in

italics in that paragraph to indicate that it is a quote from Gartner.

Mary Scanlon: I do understand the italics. I am aware of the difference.

Iain Campbell: The keeper made it clear that we are not blaming BT. I do not see how she could have made it clearer.

Mary Scanlon: Paragraph 14—this is not in italics, Mr Campbell—states:

“RoS now believes that the Partnership arrangement was fundamentally unsuitable for a public body. Some of the reasons for that view are set out below.”

And please do not insult me on a committee.

Sheenagh Adams: I am sure that my colleague did not in any way intend to insult you. We just want to clarify our position.

As I said, we are not blaming BT. The view of the management team, which was not around at the time—and, obviously, the world has moved on considerably—is that it was the wrong type of contract for Registers of Scotland. We did not have, either at the time or subsequently, sufficiently skilled and expert staff who would have been able to make good use of it, if it had been able to work, but we feel that the fundamental issue is the nature of the contract.

Our new IT strategy means that we will be delivering our IT through a mixture of in-house experts working with small and medium-sized enterprises, which will, I hope, be keen to work for us. Certainly in the case of the company that John King has worked with on the crofting register, that has gone very well.

In no way are we criticising BT, just as we would not expect it to be at a public forum criticising us. As I said earlier, we have had successes in the partnership. The delivery of ARTL was one, although it had its problems, and we have successfully delivered services to our customers across Scotland over the whole period of the partnership. We are now undertaking our registration work more quickly, more accurately and with fewer arrears than there have ever been in the past. We continue to have very high levels of customer satisfaction and we have very good relationships with our customers.

Tavish Scott (Shetland Islands) (LD): I am intrigued by the argument, which in many ways has gone full circle over 13 years of devolution, that it is better to procure such services through a combination of in-house IT and small organisations, which you just described. Is that now the logical position that you take in this context? You mention in your submission the wider Scottish Government IT strategy and various working boards, groups and so on. Is that the

approach that you now take and will you be advising the Scottish Government on it as well?

Sheenagh Adams: That is the approach that we want to take in our organisation, for our business needs. We are a specialist user of IT services as we are the only land register organisation in Scotland. Where it is appropriate for us to share with other parts of the public sector, we will do that. We will feed our views in. Both Catriona Hardman and Iain Campbell are contributing to that. Iain, would you like to give your professional view?

Iain Campbell: My professional view is that I find it difficult to believe that an organisation that is many times larger than a small-fry organisation such as Registers of Scotland could possibly be aligned with it. How could it ever be aligned? We would be just one of the many clients of a large organisation, as any other agency of our size would be. In any relationship, it is not a good starting point when one partner is bigger than the other. It is not a good starting point in personal relationships and it is not a good starting point in business relationships. There should be equality, or at least a complementary quality in the skills and experience of the two organisations.

We are switching, where possible, to using smaller organisations. They will jump through the fieriest of hoops for a larger organisation. We are a public body and we have public money to spend. The private sector lines up to get public money. The private sector thinks that public money is easy money. It is much harder for small companies to exercise control over public bodies than it is for larger organisations. Personally, my trust lies with smaller organisations much more than with larger organisations. I think that smaller organisations—

Tavish Scott: We get the point, but given your professional expertise in IT, I presume that you accept that the principles are the same no matter what your business is—whether it is Registers of Scotland, the health service or some other part of the public sector. This is the Public Audit Committee and we are responsible for looking at the audit of public money. We are constantly told that the principles are the same in terms of the provision of services in the public sector.

You have just said that your approach to providing IT services is demonstrably different from that in any other part of the Scottish public service. Do you accept that?

10:30

Sheenagh Adams: Other parts of the public sector take a mixed approach. That was recognised in the McClelland report on procurement in relation to IT.

Tavish Scott: I do not think that that is true. Other parts of the public sector are being told to procure on a Scotland-wide basis with the big providers and companies that you have just criticised.

Sheenagh Adams: That works sometimes, but it depends on what we are doing. Obviously I expect to work with the rest of the public sector in getting access to the internet or desktop supplies and that kind of thing, but it has to be horses for courses. Catriona Hardman might like to add to that.

Catriona Hardman: When we are talking about a big contract for infrastructure, we are probably looking at larger providers—

Tavish Scott: I am not talking about that; I am just talking about IT.

Catriona Hardman: The situation is probably mixed. If you are looking at the provision of broadband services, you will be looking at a larger supplier. The problem was that ROS put all its eggs into one basket with the partnership. BT provided all our services, so we were in a bit of a straitjacket. We could not pick and choose and decide to go somewhere else to get a different bit of IT. BT provided everything—it kept the lights on, and it also provided our IT development. ROS is a public organisation that has evolved a lot during the past eight years, so that simply did not work. Life has changed, and highlighted in many of the reports that we have obtained was that one of the main problem areas was the length of the contract. A public body would not now expect to go for a huge one-stop service for bespoke software or an IT package. We would now be looking at getting a much more generic service.

I am not an IT expert but I know that the whole ethos has changed. We entered into a partnership because that was the name of the game. We had big bespoke registration services and for that we needed a big supplier that would provide us with everything. As I said earlier, we expected that just having innovative IT would somehow change how ROS worked—that was a fundamental error, in my view. As I said, I have only been at ROS for the past three years, but I think that that is what happened.

Tavish Scott: I think that you are right, but what you describe is not the way in which Government procurement is going. I take your point that, although ROS is part of the public sector, it is not directly a Government body. It is part of the public administration in Scotland, but it is not a ministerial body. I am nevertheless intrigued to see the very clear difference between your approach to IT procurement and the one that we are constantly being told is the right one for Scotland.

I also take your point that ROS was able to procure the crofting register for £600,000 as opposed to a higher cost, but the Public Audit Committee needs evidence that demonstrates that the ROS approach will provide procurement savings to the public sector in a manner that is quite different from the one that we are being offered by any other chief executive—or keeper—who comes along to talk to us.

Sheenagh Adams: Our assessment of the approach that we are taking shows that we expect to make at least 30 per cent savings on the service costs of our IT provision each year in future. That is a reasonable estimate; we hope to achieve more than that. We certainly hope to make savings on the development of the crofting register. We are taking this approach because we want to get it right. We have learned our lesson and we do not want to be sitting in front of the committee in future.

Tavish Scott: I agree; I appreciate that.

When the issue came to the committee previously, some fairly serious questions were asked about the role of your external auditors and the way in which they did not discover what was going on. Has ROS changed its external auditors since then?

Sheenagh Adams: Yes. The contract with Grant Thornton has now ended, and Audit Scotland has now come in as our external auditors. Because we have Pricewaterhouse Coopers as our internal auditors and have had contractual relationships with others who are on the Audit Scotland list, Audit Scotland, by default, had to become our external auditors.

Tavish Scott: Are your internal auditors the same ones as when the problems happened?

Sheenagh Adams: We have been working closely with our internal auditors, who have helped the management team to consider the issues.

Tavish Scott: One of the findings of the Audit Scotland report was that the internal auditors missed the problems.

Sheenagh Adams: Well, obviously, I mean—

Tavish Scott: I am just asking. You would be entirely justified in changing your internal auditors as well, would you not?

Sheenagh Adams: The extent of the problems with the partnership came to light only when we assessed that the e-settle project was going to fail. That was in 2010. There was not really anything to miss. Obviously, the auditors were aware of all the actions that we had taken on ARTL.

Our internal audit arrangements are out to tender. Our audit committee is entirely non-executive, and its members have all been helpful

in working with the management team to ensure that the lessons have been learned and that we have new systems and procedures in place for the future.

Colin Beattie (Midlothian North and Musselburgh) (SNP): I have several questions. I will start by asking a bit more about the in-house capability.

Your approach goes against the general trend in the private sector, where technical capabilities tend for the most part to be contracted out, except for those that are for maintenance of legacy systems, for example. You seemed to indicate—correct me if I am wrong—that the in-house IT capability will also be used for procurement. It seems to me that that might be a bit of a knee-jerk reaction to your experience with BT.

You seem to be focusing on using smaller IT providers. Do you have a due diligence process for that? I have considerable experience in IT procurement and I have never seen any evidence that there is any advantage, or disadvantage, to using a small provider over a large provider unless the small provider has a highly specialised capability. I am interested to know how you handle the process.

Sheenagh Adams: To give an example, in developing the crofting register, we used the Scottish Government's framework arrangements.

We work closely with the Scottish Government procurement directorate. We have our own procurement team, which has the superior rating and has just, yet again, improved. We will use a small team of internal experts, some of whom will do development work themselves. Others will work with the contractors that we will use.

Some of the small companies that we will use will be third-party contractors that will come over to us at the end of the BT contract. They are companies that BT has used to do some of the work, particularly on maintaining services. Some BT staff will come over to us as well.

I ask Iain Campbell whether he wants to add anything, as he will lead on that work.

Iain Campbell: You made a number of points, Mr Beattie. Correct me if I do not cover them all, please.

The TUPE legislation mandates that, at the end of the contract, the new provider of the service takes on the staff who currently provide the service. That day-to-day service provision is coming to us anyway. That continuing commodity service—I do not want to belittle it, but I will use that phrase—will be provided in-house because it has to be transferred to somewhere. We believe that, by transferring it in-house, we will have much

more control over it. I will return in a second to why we think that that is important.

The in-house expert team that we are building will be used for the design and development of new systems. Although, as Sheenagh Adams said, much has been done over the past seven to eight years under the partnership, Registers of Scotland, which I joined a year and a half ago, is a coiled spring of business process improvement.

John King's registration department, which accounts for 900 of our 1,000 headcount, is absolutely desperate for business process improvements. It is doing such improvements anyway, but is struggling with the IT. The nature of the contract and the arrangements in it made it difficult for his department to change and do new things to improve its processes.

In my opinion, we have a lot of catching up to do in relation to the degree to which we can be efficient and improve our business processes. We need to take control. Handing that over would be fine if it were business as usual, but it is not business as usual; we are catching up and are making significant improvements. The process needs tighter and finer-grained control than one would get if one were to have a contractual arrangement with an external party.

As I think Sheenagh Adams said, we will use the normal Scottish Government framework arrangements to get the suppliers for the smaller pieces of work. I will try to answer your question. One could discuss endlessly the suitability of small companies versus that of large companies for various activities, but I would rather talk about granules of work and whether they should be small or large. One lesson that we feel has been learned during the contract is that the approach of taking on a single large granule of work that involved doing so much for the organisation over eight years was fatally flawed. It is not possible to have control over such a large piece of work, and it is delusional to think that, at the start of such a project, one would know what would be required later on; it would be delusional to think that even halfway through the timescale. Business, regulatory and legislative environments change, as do people and fashions. Everything changes. We have to have smaller granules of work.

I think that Tavish Scott was heading in the direction of asking about big contracts versus small contracts rather than big providers versus small providers. One can take a risk view. If one takes on a big granule of work, one is committed. One puts on the fount of sincerity, writes the spec and it is a case of, "Forward, chaps! Off we go!"—to oblivion, most likely. If, on the other hand, one has small granules of work, the monetary and emotional investment, and individuals' career investments, in those small granules are smaller,

so when those granules fail—and they will; that is the normal course of human existence—it is easier to say, "Hmm, that was a failure. Let's push that to the side. Let's do something different. Let's replace it with something else." Very little time and money will have been lost because it was a small granule, and none of us will have lost face. Behaviourally, psychologically, financially and in risk management terms, that is a much better solution.

The Convener: We need questions and answers to be a little more succinct, Mr Campbell.

Colin Beattie: What is the definition of an intelligent client?

Sheenagh Adams: It is someone who has a professional background in the subject that they are looking at, who has a wide range of experience in different types of settings and who has kept their professional knowledge up to date. We look to solicitors, doctors and accountants to do that, and that is what we are now trying to do with our IT function—to have staff who are professionally qualified and who have experience. Previously, that was seriously lacking in Registers of Scotland.

Colin Beattie: Does that definition of an intelligent client include users as well as IT people?

Sheenagh Adams: Yes—users have to have an understanding, too. We are working with Iain Campbell's team to improve our ability, as senior managers in the public sector, to understand the intelligence around IT issues. It is not going on a training course that makes you an intelligent customer; it is something that you gain through experience and through working with your colleagues.

Iain Campbell: I would like to add something—I will keep my remarks short.

It is not just IT skills that are required—hard-nosed business skills are required, too. The public sector is not very good at hard-nosed business skills. Normally, the hard-nosed business skills are on the other side of the table. The larger and more powerful the company, the more slick and polished it will be at those hard-nosed business skills.

Colin Beattie: I think that you have had your fingers burned and you are reacting to that.

One comment that was made was that when the supplier—BT, I presume—had a problem, it would go straight to senior management and bypass the team on the ground that was supposedly managing the project. How could senior management think that that was the right process to be followed?

Sheenagh Adams: That does not happen now, and it has not happened while we have been leading on the project. A lot of that was to do with the relationships that had built up. Previously, the senior managers in Registers of Scotland had worked with their counterparts in the supplier for quite a long time, and people just used those business relationships.

10:45

To come back to what you said, and to reassure Mary Scanlon, we are not saying that it is BT's fault. We will have an on-going business relationship with BT, as it will continue to provide support for the specially written software that has been used during the partnership, which we will continue to use for a period of time. We will have a relationship with a big supplier as well as with a range of smaller suppliers.

Sandra White (Glasgow Kelvin) (SNP): Having listened to what has been said, it seems to me that the original contract that was drawn up eight years ago has been the nub of the problem that ROS has faced. You can give me a straight yes-or-no answer on that.

I know that none of you was around at that time, but were staff and management involved in the day-to-day running of the contract?

I do not think that I would have drawn up an eight-year contract. If I was looking for insurance or something, I would be looking for a bidder every three or four years.

I just want to confirm that the problems lie in the particular way in which the contract was drawn up in 2004.

Sheenagh Adams: That is our assessment, as the current management team.

Sandra White: What lessons have you learned, and what has been put in place with regard to management skills and the culture of ROS?

Sheenagh Adams: A range of things have been done. We have revisited our governance structures. Catriona Hardman led on that work, as she said, and we have new governance arrangements in place under which future programmes will be directly accountable to her as accountable officer and not to a hybrid committee that is made up of the supplier and the business.

We have trained our staff on managing projects, offering refresher training for those who have qualifications and training for people who have perhaps not had it before. That includes training for us as senior responsible officers within projects and programmes.

As we said earlier, we have brought in delegated budgeting.

With regard to staff with skills and experience, we have brought in Iain Campbell. His predecessor, who came in and then left, was professionally qualified and had a range of experience. Iain has brought in a small team of staff with real qualifications, experience and know-how.

Unfortunately, we lost our finance director, who left to pursue an academic career, but we have a new finance director who has experience of managing and of being involved in the financial control of major IT and investment programmes in the public sector.

We have legal services people such as Catriona Hardman. Our legal services directorate contains primarily staff who are on secondment from the Scottish Government legal directorate and who have the skills to help us work with our external legal advisers to look at commercial arrangements.

As I said, we have a new ICT strategy that focuses on how we develop our IT and ensures that we do it in manageable chunks in a way that provides good value. We will continue to work with our stakeholders on that; we have a stakeholder forum that meets regularly at which we share our views and our thinking on that.

Sandra White: I am quite happy with that answer—the witnesses have answered all the questions that I wanted to ask, convener.

Willie Coffey (Kilmarnock and Irvine Valley) (SNP): I have some experience on the software engineering side, and in project management and specification and so on. Listening to that story reminded me of some of the fatal mistakes that have been made over a number of years—

The Convener: By you?

Willie Coffey: No, not by me—by others. *[Laughter.]*

If someone goes into an electrical shop and does not fully articulate what they want, they are likely to come out with a tumble dryer when they really wanted a washing machine. I do not know whether that daft analogy is relevant, but it sounds like that type of story. In the early days, staff in the organisation were not capable of articulating its requirements. That is not to blame BT, which as the vendor probably did its best to help the organisation understand what its requirements were. What happened has been a common fault in IT procurement projects over the years and was probably the root cause of the difficulties. Like me, however, I think that other committee members will wonder how on earth it took such a while for that to dawn on anybody and why there was no earlier intervention to try to correct or rescue the situation.

I wonder about the organisation now. You guys are giving us the impression that you fully understand what went wrong and that you have taken proper steps to ensure that it does not happen again. The role of the intelligent client was mentioned, but at no time should the vendor become the intelligent client: you are the client and you should be telling the vendor what you need. If you cannot do that, you get somebody in—but not somebody from the vendor; that is a bit like asking a car salesman to sell your car.

The other point that has caused a bit of discussion was the change request aspect, for which Mr Campbell offered an explanation. However, most software development projects get thousands of change requests, so I do not think that that is really a big issue. Although it was highlighted in the Audit Scotland report, it is not a big issue; the main issue is the failure to articulate requirements at an early stage. The work that the Public Audit Committee has done over the years has shown that that is a common thread.

What I am looking for from the witnesses is some sense that you fully understand what happened and that systems and people are in place in the organisation to ensure that the situation is corrected and does not happen again.

Sheenagh Adams: That is exactly our assessment of what was wrong, in that we did not have access to expert advice on and knowledge of how systems work. The arrival of Iain Campbell, with the team that he brought in, has enabled us to make the decision to terminate the partnership contract early and get out two years in advance. We now understand the nature of the technical issues that we were not in a position to understand or to think about before. That has made a huge difference for us. Obviously, a departure two years early will save about £3 million a year in service costs.

We have now demonstrated that we can develop and deliver IT projects well. John King has been working on the crofting register and was involved in work with the supplier. I ask him to say a few words about how that went.

John King (Registers of Scotland): I very much echo Willie Coffey's sentiment. One of the key issues that I have experienced in an operational management role for new IT is around requirements. The great benefit that I have seen, particularly with the crofting register, is the intelligent client function, which Iain Campbell's team has provided and which is essentially about taking an operational requirement, putting some technical language around it and then interacting and discussing what the requirements are in a way that an IT company can understand.

I emphasise that the crofting register required a highly complex piece of IT. It is not unlike the land register, so there is a large spatial element to it, a textual element and a public-facing element. It is unlike, for instance, a stamp duty land tax system or a land and buildings transaction tax system, because it is a much more complex piece of work. The company Informed Solutions started work in March this year and the crofting register is now ready; it will support the commencement of the new crofting legislation later this year. One of the big reasons why we have been able to deliver that in a short period of time is the intelligent client function, which can help us to work more effectively with a particular IT company.

Willie Coffey: That is more encouraging than what I have heard previously, or what I read in the report. Before you get a piece of software running for an organisation, it is dangerous to commission it on a promise of what it will do. You have to see it working and functioning at some stage if you can, either with a client who has bought the same thing or by commissioning it in stages, to which I think Mr Campbell referred. I have not heard about software granularity for a wee while, but that is a wise step for this business to take.

Mary Scanlon: I have a quick supplementary question following on from Colin Beattie and Willie Coffey's point about the intelligent client. It is a critical point. You may not be an intelligent client—you may not have been able to live up to Audit Scotland's expectations in that area—but we cannot question the intelligent client status of the Scottish Government. The key messages section on page 6 of the Audit Scotland report says:

"The Scottish Government was unable to provide the three public bodies with all the advice and support they sought".

How can things be done better in future? As regards your capability to collect the stamp duty tax in 2015, you may not have all the expertise. According to Audit Scotland, when you asked for help from the Scottish Government, that help was not there. Do you feel, given your experience—I want to move forward positively—that that intelligent client function and additional support should be in the Scottish Government?

Sheenagh Adams: We need a dual approach. We want our own in-house intelligent client function—someone who understands our business. We would welcome it if they could work with colleagues in the Scottish Government so that they can bounce ideas off one another and so that the Scottish Government can act as—

The Convener: I think Mary Scanlon's question is whether you are getting that help now, as it appears that it was not there in the past. Do you feel that you are getting that help now?

Catriona Hardman: Certainly since the e-settle failure we have had regular dialogue with the Scottish Government that has covered finance, procurement and legal issues. As Sheenagh Adams said, ROS as a NMD was aware that we had to rebuild our own IT expertise and put our own house in order. I do not think that there was any assumption that IT staff would come from the Scottish Government, but in all other overarching aspects of the partnership we have had regular dialogue with it.

We clearly had help from ISIS—the information systems and information services division in the Scottish Government—in arranging the project reviews for the two failed projects. That was really excellent, useful work. We have also had dialogue with the centre for excellence on the two delayed gateway reviews, so we have regular dialogue in those areas.

We are now using some of our new expertise to feed into central Government IT strategy and the Government's thoughts on that; of course, we are working with the Government on the land and buildings transaction tax, too.

James Dornan (Glasgow Cathcart) (SNP): I recognise that the core of the problem may well be the contract that was written a long time ago. Clearly, I have some sympathy with the imbalance with a much larger partner over a period of time. However, as far as I can see, that does not really explain the points that are made in paragraphs 30–31 on page 11 of the report about the individual projects lacking

“detailed costs, benefits and milestones”

and about

“No progress updates on the programme as a whole”

being “provided to the ... Board”.

Why did that happen? Can you assure me that changes have been made to ensure that it does not happen in the future?

Sheenagh Adams: Certainly. In terms of the costs and benefits, there was no delegated budgeting in place in Registers of Scotland until I became keeper and I got the new finance director to bring it in. There was no accountability for expenditure on individual projects by the project manager. People thought that it was quite acceptable to get more money and to keep spending because the business-case process that was in place looked at the original project and then did a business case for any changes or add-ons to the project without relating it back to the main business case. That has been changed—a new business-case system has been brought in and is being closely overseen by the finance directorate, rather than sitting in the information directorate, as it did in the past.

I mentioned the problems with the governance arrangements that were set out in the contract. That has been completely changed—the governance arrangements that are now in place are clearly within the management structure in Registers of Scotland, with all programmes and projects having a line straight up to Catriona Hardman, as accountable officer. I assure that committee that we have identified the issues and have made the necessary changes to ensure that such issues do not happen again.

We have also brought benefits realisation actions into projects so that we have clear expectations of what projects are supposed to deliver, which we will measure throughout the projects. At the moment, they are being used in the transition project that is bringing control back from BT to ROS, and they are clearly working. Catriona Hardman chairs the project board weekly, and there are regular updates to the executive management team and to the board, when it meets, and they feature on our risk register. We have put all those things in place and are adhering to them strictly.

11:00

Colin Keir (Edinburgh Western) (SNP): Good morning. I think that most of my questions have been asked. You are obviously in dialogue with Scottish Government agencies. I would like to clarify something in the report—although I am sure that you have probably done it in another way during your depositions. The findings of independent assurance reports—gateway reports—are mentioned in paragraph 35 on page 12 of the Audit Scotland report, and paragraphs 42 and 43 bring up the same sort of thing. Information was brought forward by those reports but was—to be frank—not acted on. Can we have some form of guarantee that more credence will be given to those independent reports?

Sheenagh Adams: There is an issue with gateway reports, which is that they are provided entirely to the SRO for the project. There is no requirement under the projects in controlled environments—PRINCE—project management process for those reports to be shared with the wider management team. One issue that we identified was that the gateway 5 report on the overall partnership had been postponed by the SRO and that there was no mechanism to tell our chief executive or the accountable officer that that had happened. We have recommended to the Scottish Government that that be changed and it has agreed to do that, so it will be visible to accountable officers and chief executives that gateway reviews have been postponed for particular reasons.

Regarding how we operate now, the SROs who receive gateway reviews share them with their management team colleagues. They are able, as an executive management team, to look at the issues in the gateway reviews—whether they be positive, negative or amber issues—and then to develop an action plan to monitor the issues, so that they do not lose sight of the recommendations that come from gateway reviews.

Colin Keir: It seems that there has been a management breakdown—a severe one, if we are being perfectly honest.

Sheenagh Adams: Yes.

Colin Keir: That takes me back to some of the things that have been said, partly by the committee and partly in your evidence. If you are saying that the management deficiencies have been cleared and that there are clear lines of communication not just between the Scottish Government, ROS and a third party but within your organisation, I might be able to see a way forward.

Catriona Hardman: After the e-settle project was halted, we had the first delayed gateway review in 2010 and we implemented its recommendations. I had probably been in post about six months or so when we started looking at the gateway review. It told us to work within the partnership to see what value we could extract from it—which echoes what was said in response to some of the earlier questions. That we did, and we improved some of our practices as a result. We ran the gateway review again one year later, and its conclusion was that we had probably extracted all the value that we could extract from the partnership in its form then. By way of reassurance, once we have completed the transition of services back to ROS, we will ask the centre for excellence to work with us on a state-of-readiness gateway review, which I think will take place sometime in the new year. We will have looked at three gateway reviews over the entire programme since I came here.

The Convener: Mr Coffey may ask a very short question.

Willie Coffey: Thank you for bringing me back in, convener. I forgot to ask our guests whether they are currently using any recognised project management software or systems to help them through the new process, and if so, what are they?

Iain Campbell: The PRINCE 2 mechanism is the standard in public sector organisations and is often the standard in large private sector organisations. It is used throughout the business and it will also be used within IT. IT development has not started in full flow yet; we need BT to exit the building, essentially, for that to start. There is a “Wizard of Oz” curtain between us and all of our IT, which will not be revealed until the end of

November. At that point software development will start for real. Some prototyping and investigative work are happening just now so that we understand the lie of the land and so on, but the real work will start on 1 December. The standard methodologies will be used and some agile methodologies, as well.

Willie Coffey: So, back in Kansas you will be using PRINCE.

Iain Campbell: Among other methodologies—yes.

The Convener: Thank you. I will close with one question to get to the heart of the main concern that has been expressed. On 7 November we are taking evidence from the Scottish Government on not ROS particularly, but ICT contracts. The evidence that you have given today will inform the questions that the committee asks the Scottish Government and I suspect that we will come back to the general approach to ICT contracts. Mr Scott has made the point that you have given very strong evidence of ROS’s view that working on smaller contracts with smaller companies is what works for you. Are you saying that BT is too big and powerful a company for a public body such as ROS ever to work with?

Sheenagh Adams: No—I would not say that, at all. We will continue to work with BT and have a contract with it. It has to support the specially written software that it has created.

The Convener: That is a legacy of the partnership.

Sheenagh Adams: It is, but the problem for us was the partnership contract, because it tied us in, was for so long, was for everything and did not have specific and sufficient mechanisms within it to ensure speedy value-for-money delivery.

The Convener: You also said that there was an imbalance in power and expertise between the client—yourselves—and the provider.

Sheenagh Adams: Yes. That was the nature of the contract, because the partnership contract was designed so that the supplier provided the intelligent client function. That was a fundamental flaw in the contract. It would not be for me to sit here and criticise and blame BT; our view is that it was the nature of the contract.

The Convener: Thank you very much indeed.

11:08

Meeting suspended.

11:15

On resuming—

“Scotland’s colleges—Current finances, future challenges”

The Convener: I ask everyone to check that their phones are off—he said, meaning that he should do that.

Item 3 on our agenda concerns Audit Scotland’s section 23 report “Scotland’s colleges—Current finances, future challenges”. With us to give evidence on the report are Caroline Gardner, who is the Auditor General; Ronnie Nicol, who is the assistant director of performance audit in Audit Scotland; and Graeme Greenhill, who is the portfolio manager of performance audit in Audit Scotland.

I invite the Auditor General to introduce the report.

Caroline Gardner (Auditor General for Scotland): The college sector has a key role in supporting sustainable economic growth in Scotland by contributing to development of the high-level skills and education that we need for that. The report aims to summarise the financial standing of Scotland’s incorporated colleges just before planned structural reforms come into effect and planned public sector spending reductions have an impact on the sector. The report is largely based on colleges’ 2010-11 financial statements, and establishes a position against which we hope to track future progress in terms of the reforms that are coming.

The financial standing of the sector was generally sound in 2010-11, although the financial position of individual colleges varies widely. Most colleges operate to relatively tight margins, and there is no consistent trend in the amount of surplus or deficit that has been reported by the sector as a whole over the past few years.

In total, colleges spent £771 million in 2010-11 and received income of £742 million, resulting in an overall operating deficit for the sector of £29 million, which is a small operating deficit overall. Most of the deficit was due to the City of Glasgow College, which reported an operating deficit of £34 million. That was associated with the redevelopment of the college’s campus, and there are no underlying concerns about its financial health.

Looking ahead, we know that the sector faces considerable challenges. The Scottish Government revenue grant support for the sector is expected to fall to £471 million in 2014-15, which is the end of the current spending review period. That is a reduction of 24 per cent in real terms. We think that the sector may also face

pressure from a range of increasing costs, such as demand for college places, buildings maintenance costs and rising energy prices.

Planned structural reforms of the college sector may also create cost pressures. They have the potential to bring a more strategic approach to management of the sector, including some savings from mergers and integration, and to bring more robust planning of education provision, which will have much wider benefits. However, complex change on that scale will inevitably mean that there will be some disruption during the transition period, and there will be transitional costs for things such as redundancy payments, relocation of staff and the integration of administrative and other systems.

It is too early to draw conclusions on the impact of funding reductions and how well college mergers are being managed, but we comment in the report on a number of risks that need to be managed during that period.

First, the Scottish Government has set the strategic objectives of post-16 education reform, but it has not yet published a quantified assessment of the overall cost of the structural changes to the sector and the expected benefits. We think that that would help to give a clearer picture of the affordability of the process ahead.

Secondly, the new regional boards have an important role in providing leadership in the merger of colleges and the establishment of federations, and in supporting the complex change management that is needed. It is therefore important that they hit the ground running so that they can play that role, and also that they establish effective links early on with community planning partnerships and enable the strategic development of course provision.

The outcome agreements, which set out how colleges will contribute to the national objectives for education and learning, need to develop further. They concentrate largely on input measures, such as the volume of learning that is to be delivered, and on process measures, such as the development of plans for structural change. They need to be taken further to look at the impact that the college sector should have on the wider education and learning agenda.

The report makes a number of recommendations to the Scottish Government, the Scottish Further and Higher Education Funding Council and colleges about what needs to be done to implement the reforms successfully.

I will stop there. As always, the team and I are happy to answer questions from the committee.

The Convener: One of the report’s key findings, to which you referred, is that

"The overall financial standing of the college sector in 2010/11 was generally sound."

That has not always been the case in the past. The report makes it clear that the financial standing of individual colleges varies, but it does not seem to ring any alarm bells, and that also has not always been the case in the past. Is it fair to say that the report's finding on where the college sector stands is generally positive and is that the sector is in a good place?

Caroline Gardner: It is certainly true that progress has been made in the past few years. You are right that some colleges have faced significant financial problems in the past. From the information that is available in their financial statements and from discussions with the funding council, none appears to be in that position at the moment.

Exhibit 4, which is on page 11, sets out the operating position for each college. Most colleges delivered an operating surplus in 2010-11. Among most of those that ended with an operating deficit, the numbers were very small. The overall deficit is more than accounted for by the costs of redevelopment at the City of Glasgow College, as I said in my opening statement.

Progress has been made, but the operating margins are tight. Given the pressures that we know are coming from rising costs, reduced central Government funding and the short-term costs of mergers, there are challenges that need to be managed carefully for the sector as a whole and for individual colleges.

The Convener: The report makes it clear that, although the starting point is good, it is fragile. The report was produced in the context of significant change being planned in the sector through the creation of regional boards and, associated with that, a number of college mergers, which is reducing the number of colleges.

It is worrying that Audit Scotland says in paragraph 58—you repeated it in your opening remarks—that

"The Scottish Government has not yet published a quantified assessment of the overall costs of the reform of the college sector and the expected benefits."

Paragraph 64 says that

"outcome agreements ... concentrate on input measures ... and process"

and do not indicate how the Scottish Government expects the changes in the college sector to produce a greater contribution to employability and the development of an educated and skilled workforce. Is it fair to say that colleges are in a good place, but are entering a period of significant change, and that we lack the rationale, the

justification and the metrics for and the expected outcomes from that change?

Caroline Gardner: We think that it is now time for exactly those specific measures and estimates of costs and benefits to be put in place. Because colleges operate to tight margins, small increases in costs or reductions in their income will have a significant impact on them.

More widely, colleges play an important role in the objective of achieving sustainable economic growth. We know that the number of young people who are not in education, employment or training is rising. The economy as a whole needs a change in the direction of skills development—for example, to achieve the aim of having a low-carbon economy, we need new skills to come from the college sector. More detailed planning for what that means through outcome agreements and better estimating of the costs and benefits of the transition are needed to manage the risks of squaring the circle.

The Convener: We have had quite a significant review—the Griggs review—and we are planning legislation to create the regional boards. Are you saying that we have gone from the review to the legislation without going through the intermediate stage of working out exactly why we are changing the sector and what we expect that change to achieve?

Caroline Gardner: The high-level objectives are clear. What are not clear are the detailed estimates of the costs and benefits of the transition and the detailed outcome measures in the outcome agreements for what the college sector and individual colleges should be contributing. The colleges need that information to be able to take the next step.

Mark Griffin (Central Scotland) (Lab): On page 3, you state:

"Government revenue grant support to colleges is likely to fall from £545 million in 2011/12 to £471 million in 2014/15."

Can you confirm that that is still an accurate reflection of the budget for Scotland's colleges?

Caroline Gardner: Yes, we are confident that those figures stand.

Mark Griffin: Thanks for that. Yesterday, at the Education and Culture Committee, the Cabinet Secretary for Education and Lifelong Learning said:

"The Audit Scotland report is accurate with regard to the published spending review figures but not with regard to the actual figures for spend."—[*Official Report, Education and Culture Committee*, 23 October 2012; c 1554.]

Are you able to comment on the cabinet secretary's comments?

Caroline Gardner: Certainly. The broad picture is that our figures for 2011-12 and 2014-15 are correct; therefore, the reduction over that period is correct. However, since the spending review there have been a number of one-off allocations in individual financial years for specific purposes, which amount to the £67.5 million that was referred to by the cabinet secretary.

Graeme Greenhill can give you more detail on that.

Graeme Greenhill (Audit Scotland): The cabinet secretary said yesterday that college finances can be quite complex, and I would not disagree with that statement.

As we say in the report, the September 2011 spending review indicated that the Scottish funding council's revenue funding for colleges would decrease from £545 million in 2011-12 to £471 million in 2014-15. However, as the cabinet secretary said, since the September 2011 spending review, additional money has been given to colleges. For example, in 2011-12, an extra £11 million was allocated to the funding council to give to colleges in respect of college bursaries and additional places. A further budget addition that took effect for 2012-13 was the £15 million college transformation fund, which was to help colleges to begin to adapt to the structural change.

The September 2012 spending review gave another £17 million to colleges in 2013-14, again through the funding council to support bursaries and college places, and just a couple of weeks ago there were further budget additions relating to 2012-13. Those added another £11.4 million to the funding council's budget for colleges and £13.1 million to the budget for Skills Development Scotland to help to fund short employability courses. The idea is that those courses will be commissioned from colleges and that money will find its way to colleges.

An additional £11 million in 2011-12, £39.5 million in 2012-13 and £17 million in 2013-14 add up to the £67.5 million that Mike Russell referred to, as Caroline Gardner just said. That is one-off funding, however, and there has been no addition to the 2014-15 budget. Therefore, the estimated budget of £470.7 million for 2014-15, as set out in the September 2011 spending review, remains the current budget for that year.

11:30

Mark Griffin: I take that on board. Although additional moneys have been allocated to particular years, was the cabinet secretary incorrect to say that your figures were not accurate? You have already stated that you believe that your figures are still correct. Will you confirm that you still believe that the reduction in

college funding will be 24 per cent in real terms, as stated in the report?

Caroline Gardner: We are confident that the difference between the 2011-12 and 2014-15 figures, adjusted for inflation, is a 24 per cent reduction in real terms. There are a number of movements in the financial years in between, as Graeme Greenhill has outlined, mainly for special, one-off purposes, which are not at this stage committed in any way to being included from 2014-15 onwards. We are confident that our reduction is correct.

Tavish Scott: I want to return to Caroline Gardner's earlier answer to the convener on the level of financial and outcomes detail. Did I understand the Auditor General correctly? She described the high-level strategy, for want of a better term, as clear—indeed, that is reflected in the report and in other areas—but said that the bit that is lacking is that neither colleges nor the regional structures yet have numbers, budget details or outcome agreements, again for want of a better expression.

Caroline Gardner: That is absolutely correct in terms of the outcome agreements for the contributions that they are each intended to make to the high-level national objectives. The part of the jigsaw that is not yet in place is the Scottish Government's assessment of the costs and benefits of the structural reform, the creation of the regional boards, and the mergers or federations of colleges. There will almost certainly be savings in the medium term as well as improvements in planning, but we know that there will be a cost in getting from where we are now to where we expect to be in the future as a result of redundancies and relocations, for example. We do not yet know the estimated cost of that.

Tavish Scott: That is helpful.

Do the proposed regions yet know their split of the budget and the figures that Graeme Greenhill has just given in respect of their budget over the next few years? Do they know even in indicative terms what the numbers will be?

Caroline Gardner: I think that they are planning on the assumption that their broad shares of the budget will remain as they currently are and therefore that the reductions and, indeed, the additional funding that is available for the years in between will be allocated on that basis. However, I will ask Graeme Greenhill to give members a bit more information about that.

Tavish Scott: When you said "they", did you mean the individual colleges? We do not have the regional structures yet.

Caroline Gardner: The funding goes from the Scottish Government to colleges via the Scottish

funding council, and it will be planning now on the basis of the spending review forecasts and the additional amounts of funding that have been announced for the years in between, up to 2013-14. I ask Graeme Greenhill to talk members through the detail of what people know at the board and college levels.

Graeme Greenhill: The report mentions the development of outcome agreements for the colleges. As part of the process for agreeing the first round of outcome agreements, the funding council has been agreeing budgets for 2012-13 with the regions. Therefore, all the regions know how much money is going to them for 2012-13.

Tavish Scott: So are the regional boards there already?

Graeme Greenhill: No. The regional boards do not technically exist.

Tavish Scott: But surely money cannot be allocated to something that does not technically exist. Or perhaps it can be.

Graeme Greenhill: Em—

Tavish Scott: I am sorry. That is a very unfair question, but it strikes me that it is a bit difficult to give money to something that does not exist.

Graeme Greenhill: By definition, the regions do not exist. Money has been allocated at a regional level, but in practice the individual colleges that make up each region know how much money they are getting for 2012-13.

Tavish Scott: Your overall finding was that there is a lack of clarity around what the regional costs will be and around the costs of implementing what will be, by any standard, enormous change in the college sector. The colleges may know the figure for next year, but do they know it for the spending review period? What element of those costs will be for regionalisation? What number and percentage are attached to the costs of regionalisation?

Caroline Gardner: That is what we are not clear about. There are two elements: the costs of regionalisation itself and, potentially much more significant, the costs of bringing together colleges in mergers or federations. For example, we know from recent press reports that the cost of the Edinburgh colleges merger was expected to be about £10 million but has actually been about £17 million. People are confident that there will be savings as well as improvements in planning in the longer term once that process has been gone through, but there is a significant cost in the short term, especially against the background of falling resources over the spending review period.

Tavish Scott: At what level of management are the changes being driven? I appreciate that the

Scottish Government has said what it wants to achieve, but who at a practical level will actually deliver these enormous changes?

Caroline Gardner: I think that that varies across the different regions of Scotland, depending on how far ahead individual colleges are with their merger proposals and depending on the specific circumstances that they face. Perhaps Ronnie Nicol can provide a bit more detail on that point.

Ronnie Nicol (Audit Scotland): In the report, we were at pains, as the Government has been, to respect the fact that the legislation is still to go through the parliamentary process. However, individuals have been appointed for the proposed new regions to start the planning of the arrangements to manage the transition. Our report was trying to get across that this will be quite a complex exercise that will take place over a period of time, so effective planning needs to be put in place. People need to be clear about objectives and how those very specific objectives will relate to the broad strategic objectives that have been outlined in the consultation documents. Those are things that need to be put in place as quickly as possible in order to navigate through this very complex period.

Tavish Scott: That is very fair. However, your example of the Edinburgh colleges merger and your earlier report into the mergers of public bodies more generally across Scotland tend to illustrate that, yes, savings can be achieved in the longer term, but in the short term inevitably, or usually, the costs have been higher than projected. At the moment, we do not have even projected costs on the mergers. You do not have them and nor has the Parliament.

Caroline Gardner: The Scottish Government has not set out the expected costs and benefits of the structural reform programme, which is part of its wider objectives and aims for this sector in the education and learning policy area.

Tavish Scott: The point that I am driving at is that your previous recommendations to the Public Audit Committee have been very clear about the need for such figures to be available at the earliest possible date. However, we are just about to have this change and we still do not have the projections.

Caroline Gardner: I have recommended that the Government should produce them. We do not have them.

Tavish Scott: Point taken. I have one final question. Paragraph 41 of the report contains a very interesting sentence, which begins:

"While the SFC does not record the numbers of people applying to attend college, the volume of learning activity".

I was staggered by that. Do we not actually know how many people apply and do not get in?

Caroline Gardner: There are not national figures for that. The matter has clearly been of some political and media interest over the past few months. Graeme Greenhill may be able to give a more up-to-date picture of where we are with that.

Graeme Greenhill: I imagine that individual colleges will have information about demand for their classes, but that does not prevent the same person from applying to two or three colleges at the same time. As Caroline Gardner said, there is no national picture of the number of people applying for college places.

Tavish Scott: It is very difficult to justify a change for whatever reason if you do not know the numbers that would justify that change. I take the point that a person might apply to three colleges, but the system should be clever enough to work that one out. If Tavish Scott applies to three different colleges, his name should ping up three times in the statistics. Does the Government—it does not matter who is in government—not just collect the statistics that would help it to make proper decisions about the level of demand?

Caroline Gardner: They are not collected by either the Scottish Government or the Scottish funding council, which might be a more appropriate place for the collection to happen given the council's responsibilities for providing funding to colleges and in future to the regional boards.

Tavish Scott: Have you reached a view on whether the collection of those statistics would help both the funding council and us in Parliament to make a judgment on these matters?

Caroline Gardner: My view is that more information on the right things is always useful and that that is one of the things that should be picked up in the outcome agreements that are being put together.

Colin Beattie: I am looking at paragraphs 25 and 30. Obviously, it is good that colleges have a surplus, but public funds should be used for a purpose. The report mentions that it is good practice for colleges to have a certain amount of prudential reserves and that the funding council says that those reserves should be enough for 60 days. What proportion of the total surplus of £206 million is project related and how much is earmarked for the prudential reserves?

Caroline Gardner: I am not sure that we have a breakdown of the figures for 2010-11, although I will ask Graeme Greenhill to confirm that. The situation varies a lot between colleges. Some colleges that are expecting significant change and

merger are deliberately building up surpluses to use for that purpose.

Can we be more specific than that, Graeme?

Graeme Greenhill: I do not think that I can be more specific on that.

Caroline Gardner: The report has been put together from the colleges' financial statements for the most recent audited financial year. The most recent financial year finished at the end of July, and we are considering how to use that information to provide a richer or more nuanced picture early in 2013 to support the Parliament's consideration of the wider reform agenda.

Colin Beattie: Paragraph 28, on page 12, deals with pension reserves. These days, pension funds seem to be a bit of a sword of Damocles hanging over everybody's head. The report talks about a deficit of £60 million. There are points about benefits to the fund through the change from the retail prices index to the consumer prices index and increased contributions, yet the deficit is still increasing, for a number of reasons that are set out in the report. How long can the deficit continue to increase before the colleges have to address it?

Caroline Gardner: As with all public sector pension schemes, that is a long-term problem, but a real one. For all pension schemes in which there is a fund—as with the colleges' pension scheme—at some point the liabilities will have to be brought back into line with the assets, which will require adjustments to contribution levels from the employers and the employees or changes to the retirement age or to other variables in the mix. Obviously, the investment performance of the funds is important.

We do not think that the problem is more significant for colleges than it is for other public sector pension funds, but the issue needs to be taken into account in considering long-term sustainability. There is no avoiding those long-term liabilities.

Mary Scanlon: I have a supplementary question on pensions. It was not only the figure of £60 million that caused me concern, but the fact that the figure was £10 million in 2007, so there has been a sixfold increase in as many years. The issue is not about the ballpark figure; it is about the fact that the figure has increased sixfold. Does that cause you concern for colleges?

Caroline Gardner: That is obviously a concern. However, an odd characteristic of the sector is that, because the pension schemes are funded, there has been a significant impact on the assets that they have invested to meet future liabilities since 2007 because of the global financial crisis and the impact since then on stock markets. It is a serious problem in the short term that will have to

be managed over the long term, no matter what. However, in a sense, simply because there are funds there to be invested, the issue looks more significant than it would if it were an unfunded pension scheme, as some of the other large, and much larger, pension schemes in the public sector are.

Mary Scanlon: Given that it is a funded pension scheme, as the local government one is, where does the money come from to make up the deficit and the pay-outs that are required and will increasingly be required given the economies of scale and efficiency savings that we hope will result from the mergers?

Caroline Gardner: That is a complex and long-term question. A number of factors come into play and will have to be managed over that period, including the level of contributions by employers and employees, the investment performance of the funds, the age of retirement of scheme members and the way in which all that comes together to ensure that, as the liabilities fall due, they can be afforded. It is important to put it on the record that the liabilities will not ever fall due on one day. They have a long lifetime of 40 years or more, as current members of the scheme head towards retirement and start to become entitled to their benefits, and that is the timescale over which the liabilities must be managed.

However, you are absolutely right that it is harder to do that in the current climate in which market returns are very low and public sector spending cuts are affecting the budgets of colleges and the take-home pay of scheme members.

11:45

Mary Scanlon: My next question is a supplementary to Mark Griffin and Tavish Scott's questions. I had the honour of being at the Education and Culture Committee, so I congratulate Mr Greenhill on explaining the figures. Professor Jeremy Peat looked at the figures two or three times and said that he could not understand them, and two college principals said that there was a downward trend and that they could not understand them. In addition, the Cabinet Secretary for Education and Lifelong Learning has said that the figures are complex.

Mr Greenhill mentioned the different pots of funding alongside the cuts. My understanding from grappling with the figures is that the main cut has been to the teaching grant. Did you drill down to that level? My understanding is that the additional moneys have been ring fenced for student support and so on. Am I right in saying that the front-line teaching grant has borne the brunt of the cuts?

Caroline Gardner: We have not yet fully drilled down to that level. Graeme Greenhill had the advantage—or disadvantage, depending on how you look at it—of spending yesterday evening following up on the Education and Culture Committee discussion to ensure that we understood the movements. We can provide you with a note on that. However, we have to do more work to look at the implications for the different elements of support to colleges.

Mary Scanlon: The latter half of paragraph 42 gives me serious cause for concern. It refers to evidence that Scotland's Colleges gave to the Education and Culture Committee:

"It said that based on current cost models and configurations, if colleges 'took on one in four'—

only one in four—

"16–19 year olds not in employment, education or training, and continued to service 18–24 year olds to the same level, there would be no funded provision left for older learners who make up over half of learners over 16 years of age".

Having spent 20 years lecturing in economics in further and higher education before I became a member of the Parliament, I am passionate about people being given a second chance at an older age when their jobs or careers have not worked out. You are saying that the Government's commitment to 16 to 18-year-olds and the colleges' commitment to service 18 to 24-year-olds mean that mature students have not got a chance.

Caroline Gardner: We cannot give you the detailed figures to answer the first part of your question, but it is clear that, against the background of funding reductions over the spending review period and the increasing demand that comes as a consequence of both the number of younger people who are not in employment or training and the need to reskill older workers to meet the demands of the economy that we want to have in future, there is a real pinch. That is one reason why we think that it is so important that the Government should set out the expected costs and benefits of the structural reform and make progress on the outcome agreements that will help to pin down exactly which students will be able to receive support from the sector.

Ronnie Nicol may want to add to my comments.

Ronnie Nicol: The part of the paragraph to which Mary Scanlon refers is a direct quotation from evidence by Scotland's Colleges to the Education and Culture Committee, which explains its view on the consequences of the cuts. Our concern is to ensure that the range of policy objectives that exist across the structural changes and the educational objectives, such as the commitment on 16 to 19-year-old students, are

looked at and managed in the round. The outcome agreements are an obvious place where that can happen. The rationing of reduced money must be organised holistically across the range of objectives.

Mary Scanlon: The main objectives are for 16 to 24-year-olds. My concern is the displacement of, the lack of opportunities for and the increased inequalities faced by older learners.

We recently looked at the lessons learned from the public sector mergers. It seemed to be a good idea to look at that in the context of, as Tavish Scott said, moving forward to college mergers. In a joined-up Scotland, I would have hoped that the lessons learned in your Audit Scotland report would be implemented. The previous Audit Scotland report on mergers said that merging bodies did not know what success would look like or what benefits could be expected from the merger. They did not know what service improvements could be expected and, as Tavish Scott said, they could not confirm costs or savings. There was

“inadequate analysis of savings and efficiencies”

and they did not know which efficiency savings that resulted from the merger would have happened anyway. As Colin Beattie said, there was very little, if any, baseline information in the first year of operation on the unit costs, staffing and quality of the service.

I was listening carefully to the answer that you gave to Tavish Scott and I wanted you to extend it to look at whether those critical lessons have been learned. Are you confident that, although the structural reform is not in place at the moment, it will be put in place and that the difficulties faced by previous mergers and savings expected but not realised mean that the colleges have learned lessons and that the mergers will deliver?

Caroline Gardner: When my report was published, the Scottish Government accepted the recommendation and it has agreed to publish the expected costs and benefits of the structural reform, specifically the mergers. I very much hope that that will take account of the range of information that we think is needed and the lessons learned from that report. We look forward to seeing it.

Mary Scanlon: Will it include the outcomes and the opportunities for students?

Caroline Gardner: Absolutely. All those things are needed to manage the costs of getting to where we need to be and ensuring that the expected benefits are achieved in practice.

The Convener: I am sure that the commitment is welcome, but is it fair to say that those criteria that your previous report found to be missing in

previous public sector mergers are all missing in this case as well?

Caroline Gardner: They are not available at this stage, yes.

James Dornan: I thank Graeme Greenhill in particular for clarifying the comments that the cabinet secretary made yesterday and putting it on the record that there was absolutely no intention of confusing or misleading the committee, which I suspect is what Mr Griffin was trying to say.

The Convener: We should not make assumptions about what committee colleagues have in mind.

James Dornan: Okay, but I am confident that that is what Mr Griffin was trying to imply.

I have a supplementary question to Tavish Scott's point about recording the number of people who apply to colleges. Do you agree that this period of time during the mergers and when new systems are being put in place would be a good opportunity to begin to do that? I agree that it would be very important information for us.

Caroline Gardner: The mergers provide an opportunity to put systems in place to collect those figures on a national basis, but they are also important for thinking about the outcome agreements that the new colleges and college boards should be signing up to.

James Dornan: Absolutely.

Mary Scanlon talked about the previous Audit Scotland report, “Learning the lessons of public body mergers”. It mentions previous college mergers. Has any work been done on the financial benefits or otherwise of previous college mergers, and has it helped Audit Scotland to write this report?

Caroline Gardner: We have not done that. I am not sure whether the Scottish funding council has done that, so I ask Ronnie Nicol to come in on that question.

Ronnie Nicol: There has been developing learning from the recent mergers. We have done a little bit of a case study and we know that the City of Glasgow College has engaged with colleagues about its experience.

The Scottish funding council recently issued guidance on mergers that takes account of our generic report on mergers. A number of things have been put in place recently to support the merger process.

Sandra White: I have listened to all the different viewpoints. The convener said at the beginning of this evidence-taking session that colleges are in a good place. Is that correct? I think that the Auditor General and the convener said those very words.

Caroline Gardner: The college sector as a whole has come a long way since the problems in the first decade of the century. The margins to which the colleges are operating are tight given the pressures that they face in future.

Sandra White: However, they are in a good place—that is what has been said. I was a bit confused when the convener came out and said that, but that is not the question that I want to ask.

I am interested in the recommendations that you made for the future strategic planning—in particular, the last recommendation in the second column on page 4 of the report, which concerns ensuring that colleges work with local businesses and the local community. Will the regional structure that is going to come about help to facilitate that? I am interested in the reference to community planning partners. It seems to me that that recommendation is not simply about education but involves everyone in the different regions.

Caroline Gardner: That is certainly one of the objectives that the Scottish Government has set for structural reform. It seems to us that the mergers could well help to achieve it.

At the moment, the pattern of colleges tends to reflect the fact that responsibility for them sat with local authorities until 10 years or so ago. Therefore, patterns of provision are still a bit historical and, to an extent, colleges have been competing with each other for students.

Bringing them together through the regional boards and, beneath that, the mergers and federations of colleges will allow a more strategic approach to determining what courses are needed where and how they meet the needs of young people, older learners, industry and business locally. It is a real opportunity in the structural reform. We would like that to be set out as part of the costs and benefits that are expected and the individual outcome agreements between the funding council and the colleges.

Sandra White: I agree that it is important that those plans are set out as soon as possible.

The last recommendation says that colleges should

“explore opportunities to reduce their costs”.

Earlier, we took evidence from the ROS about its big IT system. Does that recommendation concern individual colleges pooling their resources for IT systems, perhaps? I just wonder what you mean by colleges exploring opportunities to save money.

Caroline Gardner: There is a range of ways in which it might be possible to reduce costs. Again, that is one of the expected benefits that the Scottish Government has set out for its reform

programme. It could mean sharing IT systems or shared services for finance staff, human resources staff and the other background services that most colleges have. It might mean rationalising provision and ensuring that a college's courses for a particular type of subject are in one place, which might bring opportunities for savings.

The key point for us is that, without clarity about how the outcome agreements will work in practice, we simply do not know what the expected savings might be and how far they will offset the costs in the long term.

The Convener: So that Sandra White is clear, I point out that my initial remarks were that the colleges were in a financially sound place in 2010-11 and that that is a good place to be. However, if their income is reduced by 24 per cent in real terms, they are unlikely to be in a good place by 2013-14.

We had some discussion about what the colleges count. One thing that they count is the number of students that they have. The report refers to a figure of 300,000 students, although I appreciate that that is not 300,000 full-time students. The witnesses said that Audit Scotland's figure of a 24 per cent real-terms reduction in the revenue budget by 2013-14 was correct. If that is the case, is it remotely conceivable that our colleges will be providing learning opportunities for 300,000 students by 2013-14?

Caroline Gardner: It is a real challenge. The 300,000 figure for students needs unpacking a bit as well. Fewer part-time students and more full-time students are coming through colleges. If you would like to know more about that, Graeme Greenhill could take you through the technicalities.

It will certainly be a challenge to meet the demand that exists, which may increase in future as we try to shift to a low-carbon economy and try to get young people into meaningful training against a background of significant funding reductions. It is a difficult circle to square.

12:00

The Convener: The other complexity is the difference between revenue and capital funding, which we have not talked about. Paragraph 46 states:

“The reductions in public sector capital funding available to colleges over the next three years mean that colleges are unlikely to be able to sustain the same level of new-build campuses”.

In the past, the cabinet secretary—indeed, the First Minister—has said that if we look at college funding in the round, including both revenue and capital funding, we will see that there is no reduction in the budgets. However, paragraph 46

combined with the 24 per cent reduction in revenue funding must surely mean that, in the round, we expect a reduction in funding for the college sector over the next few years. Is that fair?

Caroline Gardner: A reduction in total funding for the college sector, both revenue and capital, is planned between 2011-12 and 2014-15. To make sure that I do not confuse the issue by getting the figures wrong, I ask Graeme Greenhill to clarify what that reduction is.

Graeme Greenhill: The budget figures that we have at the moment for capital funding for colleges—that is, funding coming from the funding council—show that such funding is expected to fall from £45 million in 2011-12 to £27 million in 2014-15. The Scottish Government's written evidence to the Education and Culture Committee yesterday spoke about investment—it is important to draw a distinction between investment and funding—increasing from £590 million in 2011-12 to £655 million, I think, in 2014-15. The 2011-12 figure is the combined capital and revenue funding coming from the funding council to colleges, whereas the 2014-15 figure includes £157 million of investment that the private sector plans to put into college estates development work. Basically, college campuses will be funded through the non-profit-distributing model. That is why the overall picture of investment—

The Convener: Sorry, let us be clear. The second figure includes the capital value of a project that will be delivered by a private finance initiative contract.

Graeme Greenhill: Yes, but it is no longer called PFI; it is called the non-profit-distributing model. For example, a big new campus is planned for City of Glasgow College and a procurement exercise is currently under way but it is being funded through the non-profit-distributing model—

The Convener: Which Mr Swinney has said is a member of the PFI family. Does that figure include the whole asset value of that project?

Graeme Greenhill: It is the planned investment for the year 2014-15.

Tavish Scott: I just want to get this absolutely right in my thick brain. In comparing those figures, I would not be comparing like with like, would I? That money is very different from the traditional forms of capital procurement that you described in relation to the 2010-11 figure—is that true?

Graeme Greenhill: The funding council is giving colleges capital investment money—

Tavish Scott: But not through the Scottish Futures Trust at the moment or anything like that.

Graeme Greenhill: No. The money is coming from the funding council.

Tavish Scott: In that sense, it is a Government grant coming through the funding council to colleges for capital expenditure. However, what you describe happening in the future is not a Government grant but a Scottish Futures Trust private sector investment in college campuses, which is a different form of investment altogether.

Caroline Gardner: It is worth being clear that the £157 million element of the total figure that relates to NPd will deliver improved infrastructure for colleges, which is important, and will also have a revenue consequence for capital budgets—colleges will have to meet the capital cost of that on a continuing basis once the investment has been made.

Tavish Scott: Is the revenue implication of the Scottish Futures Trust investment clear and detailed?

Caroline Gardner: Not at this stage.

Tavish Scott: So that is something else we do not know.

Caroline Gardner: These figures were discussed only in the past few days as part of the submission that was examined at the Education and Culture Committee.

Tavish Scott: I appreciate that.

Caroline Gardner: We have been able to reconcile the £655 million with the figures in our report and demonstrate how they relate to each other. We do not have any detail about the revenue consequences of the £157 million, but there will be consequences.

Tavish Scott: Thank you.

Caroline Gardner: We could provide a note on the issue, convener, if that was helpful. I realise that it is complicated.

The Convener: Mr Greenhill has offered to provide further detail to the committee. I think that that would be helpful, given that everyone seems to have acknowledged that the finances are complex.

Willie Coffey: I was going to ask about capital funding and so on, convener, but the issue was raised in the previous round of questioning. Instead, I will focus on an aspect that is covered in the report, rather than on matters that are not but which we hope will be covered in future reports.

On page 10 of the report, you say:

"The overall financial standing of the college sector ... was generally sound"

and refer to

"accumulated surpluses totalling £206 million and ... a combined £205 million of cash and cash equivalents".

My simple question is whether those are two separate amounts, which means that there is a total of £411 million.

Caroline Gardner: No.

Willie Coffey: What does it mean, then?

Caroline Gardner: I do not think that you can simply add those figures together, but I will ask Graeme Greenhill to take you through the detail of it.

Graeme Greenhill: The income and expenditure reserve is a reflection of colleges' ability to generate year-on-year surpluses over a number of years. That is different from cash and cash equivalents, which basically comprise free cash for paying on-going running costs such as monthly salary bills, investment money and so on. Some of that cash will undoubtedly have been generated through the accumulation of year-on-year surpluses, but you cannot really add the two together, as that would be double counting.

Willie Coffey: So the real figure is £206 million.

The figure is mentioned again in paragraph 26, in which you say that the asset has doubled since 2006-07. I think that that is testament to the college sector's good performance over a number of years. Indeed, I probably read the previous report about 2006-07 as a member of the previous Audit Committee.

I think that a really good story is hiding in that little paragraph. What is principally responsible for the doubling of the college sector's cash assets in that short space of time?

Graeme Greenhill: Again, we probably need to make a distinction between the income and expenditure reserve and the cash reserve. The former has been accumulated over a number of years through colleges' ability to deliver year-on-year surpluses, and exhibit 5 on page 12 shows how much of that reserve belongs to each college.

How colleges have individually been able to generate that reserve is probably best answered by the colleges themselves, but one might ask how, for example, Aberdeen College has managed to build up a healthy income and expenditure reserve through surpluses over a number of years. It is a big college, so there might have been economies of scale or it might have benefited from the oil industry by developing training courses in oil-related subjects that are delivered and paid for by the private sector.

How those reserves have been built up probably differs from college to college, and I think that the colleges themselves are better equipped than I am to explain how they reached that position.

Willie Coffey: That is very interesting.

I recall hearing at a previous meeting that the college sector's cash reserves are healthy. However, now that we are moving into the merger process, where will these reserves and assets go? Presumably they will become the cash reserves for the new merged body, but to what purpose will they be put in future?

I have to say that I see the reserves accumulating year on year, and it is a great story that should be commended. Given the current economic climate and given that budgets from the United Kingdom to the Scottish Government are being cut—I realise that we can argue about that all day—I think that this shows a healthy side to the story of college performance over a number of years, and I am keen to find out how the money will be deployed in the future that we all face.

Caroline Gardner: Some of the reserve will have been built up deliberately with the aim of enabling either mergers or the redevelopment of college campuses that might deliver savings and other benefits in future. Part of it is planned; it is not like a piggy bank into which people put money year after year. Very often reserves are built up with a specific purpose in mind, and one reason why we think it important for the Scottish Government to set out the expected costs and benefits of the structural reform is that the reserves are one source of meeting the costs of it.

The funding council has put a lot of effort into ensuring the financial sustainability of colleges over the period. You will recall discussions about individual colleges that were struggling seven to 10 years ago, and we are not seeing that sort of thing to the same extent now. We would expect the reserves that are being built up to transfer to the new merged colleges or to be available to the federations, if that is the preferred approach, but that is not yet clear from the way in which regional boards will carry out their responsibilities. The situation may vary from place to place.

The Convener: I thank our Audit Scotland colleagues for their evidence. We look forward to Mr Greenhill's elucidation of further education sector finance. It should be a treat.

We will now move into private session. I invite the Audit Scotland witnesses to remain to give evidence and ask members of the press and public to leave.

12:11

Meeting continued in private until 12:33.

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e-format first available
ISBN

Revised e-format available
ISBN 978-1-4061-9792-1

Printed in Scotland by APS Group Scotland
