The Scottish Parliament
Pàrlamaid na h-Alba

Official Report

PUBLIC AUDIT COMMITTEE

Wednesday 6 November 2013

Session 4

Wednesday 6 November 2013

CONTENTS

PUBLIC AUDIT COMMITTEE
14th Meeting 2013, Session 4

CONVENER

*Hugh Henry (Renfrewshire South) (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)
*Bob Doris (Glasgow) (SNP)
*James Dornan (Glasgow Cathcart) (SNP)
*Colin Keir (Edinburgh Western) (SNP)
*Ken Macintosh (Eastwood) (Lab)
*Tavish Scott (Shetland Islands) (LD)

*attended

THE FOLLOWING ALSO PARTICIPATED:

Angela Canning (Audit Scotland)
Audrey Cumberford (West College Scotland)
Gemma Diamond (Audit Scotland)
Martin Fairbairn (Scottish Further and Higher Education Funding Council)
Caroline Gardner (Auditor General for Scotland)
Laurence Howells (Scottish Further and Higher Education Funding Council)
John Kemp (Scottish Further and Higher Education Funding Council)
Tricia Meldrum (Audit Scotland)
Margaret Munckton (Perth College)
Susan Walsh (Glasgow Clyde College)
Alan Williamson (Edinburgh College)

CLERK TO THE COMMITTEE

Jane Williams

LOCATION

Committee Room 5

Scottish Parliament

Public Audit Committee

Wednesday 6 November 2013

[The Convener *opened the meeting at 09:30*]

Decision on Taking Business in Private

The Convener (Hugh Henry): Good morning and welcome to the 14th meeting in 2013 of the Public Audit Committee. I ask everyone to ensure that all electronic devices are switched off.

Under agenda item 1, do we agree to take items 4 and 5 in private?

Members *indicated agreement.*

Section 23 Reports

"NHS financial performance 2012/13"

09:30

The Convener: Item 2 is consideration of a section 23 report, "NHS financial performance 2012/13", which has been circulated to members. I invite the Auditor General for Scotland to brief the committee.

Caroline Gardner (Auditor General for Scotland): Thank you, convener.

The report examines the financial performance of the national health service for 2012-13. We also comment in the report on the financial sustainability of the health service, recognising the challenges and pressures that face the delivery of healthcare services. We publish such a report annually, which allows the committee to monitor progress on how the NHS is responding to the challenges that it faces.

We highlight in the report that NHS budgets are getting tighter and demand for healthcare is rising due to an ageing population, more people with long-term health conditions and the impact of factors such as increasing rates of obesity. The way in which health services are provided is also changing, with technological innovation and the planned integration of health and social care. Those changes present significant challenges for the NHS.

We found that the NHS in Scotland managed its finances well in 2012-13. All boards met their financial targets and overall they reported a small underspend of £16.9 million against a total budget of £10.9 billion. The surplus is just 0.16 per cent of the total budget—that highlights the very active management and monitoring of the annual financial position that goes on in boards and in the Scottish Government.

Given the increasing pressures facing the health services, the NHS needs to increase its focus on long-term financial planning and sustainability if it is successfully to make the changes necessary to meet the growing demand that it faces. Boards produce financial plans that cover between three and five years, but their detailed financial planning is limited to the first year of the plan. We have previously reported that the NHS will need to think more radically about how to deliver services in the longer term. NHS boards have started planning for that, but they have not carried out detailed financial planning to ensure that their strategies are affordable.

Boards made significant savings of £270 million in 2012-13 and achieved the Scottish

Government's target of saving a minimum of 3 per cent of their baseline budget. NHS boards also set their own savings targets to break even and overall they made 99 per cent of those savings. However, they relied more than planned on one-off savings, which makes the challenge of finding the same level of savings in future years even harder.

The report recognises that the NHS has made good progress in improving outcomes for patients, such as reducing death rates from heart disease, stroke and cancer, but there were signs of pressure in the system in 2012-13. For example, not all boards met their waiting times targets; vacancy rates for consultants and for nursing and midwifery staff increased; and boards increased their use of bank and agency nursing staff and their spending on private sector healthcare. Spending in those areas is still a small part of the overall budget, but the increase reversed the trend of declining spend in those areas in previous years. Auditors also reported that the introduction of the treatment time guarantee in October 2012, which gives eligible patients a statutory right to inpatient or day-case treatment within 12 weeks, has been a particular pressure on NHS boards and it remains a challenge for the future.

We make a number of recommendations in the report to both the Scottish Government and the health boards. I will highlight two of those recommendations. First, the NHS needs to increase its focus on longer-term financial planning to show how the pressures and challenges will be managed. All boards should ensure that they follow good practice, including the use of appropriate methods for modelling future expenditure and for looking at different scenarios. Detailed financial planning should underpin all boards' strategies, including workforce, asset management and information technology strategies.

The Scottish Government should also consider moving away from the current framework of annual resource limits, against which each NHS board needs to break even. That would help boards to plan for the longer term and would lead to fewer movements in their budgets during the year.

Secondly, savings are an integral part of the boards' plans to break even, so it is important that their savings plans are realistic and achievable. Boards should improve the accuracy of their short-term savings forecasts in the context of the longer-term financial planning framework.

My colleagues and I will be happy to answer questions from the committee.

The Convener: Thank you. If Angela Canning, Tricia Meldrum or Gemma Diamond wishes to contribute, they should just let me know.

I would like to ask about the impact that the financial circumstances are having on waiting times. I refer to exhibit 15, which gives the statistics for the quarter or month ended 31 March 2013. It is clear that there has been significant success on child and adolescent mental health services and drug and alcohol treatment, but there has been significant failure on outpatients, which is probably where many people have their interface with the health service. There has also been significant failure on inpatient/day-case treatment times—of the major health boards, only Lanarkshire NHS Board achieved the target.

On accident and emergency waiting times, which is an issue that people feel very passionately about and in relation to which many claims are made about access, there has been significant failure, including in Lanarkshire, where we are told that there has been major investment and major improvements. Those health boards that cover the major population centres, with the exception of Tayside NHS Board, have all failed to meet the A and E waiting time target. Delayed discharges are of significant concern in the areas with the highest levels of treatment. On the second page of exhibit 15, which is on page 37 of the report, only the commendable meeting of the cancer targets gives any glimmer of hope.

In describing the financial performance of the NHS, you identify some of the pressures and stresses that it faces not just this year, but in future years. If the statistics that you have reported pertain at the moment, can we expect any improvements in the future, when the NHS will be on tighter budgets?

Caroline Gardner: You are right that the figures in exhibit 15 demonstrate signs of pressure in the health system. That is one of the messages of the report as a whole. The backdrop to that is a great deal of activity to manage the finances, the health improvement, efficiency and governance, access and treatment targets, and the other things against which the performance of the health service is monitored.

There are real pressures there, which the health service is working hard to manage. That is why our recommendation about the need for stronger long-term financial planning is the most important one that we make. Our sense is that the constraints on funding for future years and the pressures that will come from an ageing population, higher expectations and the impact of things such as the new treatment time guarantee mean that the status quo will not deliver the change that is required. Health boards and the Government need to ramp up the work that is being done to redesign services and to think more radically about how they can be delivered. We think that that requires better long-term financial management, including scenario planning and longer-term forecasting of the likely financial situation.

The Convener: I understand what you say about financial planning. Better, more effective financial planning can make a contribution, but if the issue is rising demand, which is a result of the demographic changes that you mentioned, linked to a greater squeeze on budgets, the boards—regardless of how good their financial planning is—will not be able to meet the targets if the money is not there to allow them to deliver. Does that mean that, in future, we will continue to see targets not being met, because of the squeeze on finances, or does it mean that, given the pressures and demands to which you referred, the targets might have to be revised because, frankly, they are not achievable?

Caroline Gardner: The long-term financial planning that we are talking about is not just forecasting how much money is likely to be available but, within that, carrying out detailed scenario planning for different ways of providing services. For example, in relation to the A and E target, you might look at ways of managing unscheduled care in the round, ensuring that people who do not need to go to A and E do not arrive at the front door of the hospital, keeping more people safely at home or, where appropriate, treating them at home. That kind of financial planning is not just about understanding the money and the pressures on it, but about ways of delivering services. Stepping back and thinking more radically about new ways of doing something and—critically—following up more widely the examples of good practice that we have seen in parts of Scotland are absolutely central to what we mean by better long-term financial planning and financial management.

The Convener: From what you know and what you have seen, are you confident that we will see positive statistics in these areas or will the problems continue because of the financial circumstances in which many boards are operating?

Caroline Gardner: We know that the pressures are real and that the changes that need to be made will have to be made over a certain period. I suspect, therefore, that there will continue to be real pressure on the targets for the next year or two, which is why we have focused on our very strong recommendation to Government and health boards that they act now to redesign and deliver services in new ways to help reverse that trend.

Tavish Scott (Shetland Islands) (LD): Is there not an inherent contradiction between the targets beloved of politicians, and the short-term financial pressures that boards operate under and have to deal with?

Caroline Gardner: My view is that any targets on their own run the risk of diverting people's attention to one particular part of the system instead of their thinking about the system as a whole. In the report, we pull out a selection of targets that matter to people and which are central to the Government's NHS policy but, both in the report and in our work more widely, we have made it clear that the answer to the A and E target is to look not just at A and E departments but at the whole question of unscheduled care, care for older people and so on. Although the Government's healthcare strategy does that well, we would like to see more of that being underpinned with detailed service and financial planning for how those changes will happen in practice against the backdrop of serious financial and demand-led pressures.

Tavish Scott: I agree, but when you were carrying out this analysis and these investigations did you not find that most territorial health boards simply do not have the capacity or time to do that work because they are under such pressure from the centre to deliver on the targets that you have outlined in the report?

Caroline Gardner: As the report makes clear, we certainly think that the focus on annual targets makes things harder. Having spoken to my auditors in all the health boards, particularly the 14 territorial health boards, I know that a lot of effort in the finance department and the Scottish Government's health directorates goes into ensuring that health boards hit their annual financial targets. Indeed, you can see that in the overall underspend of 0.16 per cent against a budget of nearly £12 billion, and there is a danger that that kind of very precise financial management gets in the way of longer-term financial planning and the detailed modelling that needs to happen. That is why we made our recommendation.

Tavish Scott: That is fine, but do you not accept that irrespective of which Government is in power it is unlikely that targets will be dropped and that, right or wrong, they are now part of the NHS? What recommendations have you made with regard to easing the pressure on health boards and allowing them to create the time and capacity to carry out the long-term financial planning that you have rightly highlighted this morning?

Caroline Gardner: Our main recommendation is about stepping back from that very intense focus on the annual targets and giving health boards more flexibility to manage things over a longer period, underpinned by strong, rigorous, longer-term financial plans. None of that should be about releasing control of the finances—obviously they have to be properly managed—but it is about focusing less on landing on a particular number on 31 March and more on shifting money and services over a longer period to meet the pressures that we have highlighted in the report.

Tavish Scott: I suppose what I am driving at is whether Audit Scotland thinks that territorial health boards can achieve that, given the pressures that they are under.

Caroline Gardner: As the detail in the report shows, there are different pressures in different parts of the country but we have no reason to believe that health boards cannot achieve that, especially if support from the Government shifts from the brokerage of and planning for annual financial targets towards a longer-term focus on the changes that are needed in a particular part of Scotland.

Tavish Scott: Is the Government likely to accept your final recommendation about

"moving away from the current arrangements of setting annual financial resource limits for each NHS board"

or does that not bring us back to the same problem that the Government loves that kind of control? I suppose that "loves" is the wrong word, but it certainly needs and wants that financial control over health boards.

Caroline Gardner: The indications are that the Government is taking that recommendation very seriously. Some technical accounting challenges and control issues need to be managed as part of that, but I believe that in his recent evidence to the Health and Sport Committee the cabinet secretary indicated that the issue is the subject of serious internal discussion. That is certainly the impression that my team has had from its discussions with the Scottish Government officials.

09:45

Tavish Scott: On page 32 of the report, you say:

"The Treatment Time Guarantee is a further pressure on NHS boards".

Some statistics have been set out in paragraphs 73 and 74 but I have to wonder what the comment that

"auditors reported that the TTG will require significant resources to achieve and sustain"

might mean in the coming year.

Caroline Gardner: I will ask colleagues to respond in a moment, but it is worth reminding the committee that we are due to publish an update on our report on the management of waiting times next month so we are viewing the issue closely against the wider picture.

Angela, do you want to pick up that point?

Angela Canning (Audit Scotland): Case study 4 highlights the situation in Lothian, where a lot of money has been invested in trying to increase capacity and pick things up after the backlog of patients that had to be dealt with as a result of the waiting list problem in the board.

Tavish Scott: Paragraph 73 gives the bald and clear statistic that 565 patients

"who were added to the waiting list after 1 October 2012, were not seen within 12 weeks."

What happened to those patients? Did they take legal action against anyone? After all, is that not the implication of the guarantee?

Caroline Gardner: I think that that is a question for the Scottish Government. As far as we know, they were treated but after the 12-week waiting time implied in the guarantee. That raises a question not only about how the situation was managed for those patients; if the pressures increase and the NHS continues to be unable to meet the guarantee, we need to be clear how that situation will be managed and what the consequences will be for patients and the health service.

Tavish Scott: My question is whether a figure has been discovered for the additional cost of meeting whatever happened to those 565 patients after the 12-week period and, if so, whether it has been audited and analysed.

Caroline Gardner: At this stage, we have not seen a figure for any additional cost. However, the situation will matter to the patients themselves and the trend will be important.

Tavish Scott: And will continue to be monitored.

Caroline Gardner: Very much so.

The Convener: Before I bring in Bob Doris, I have a question of clarification about the points raised by Tavish Scott. I note that spending on private sector healthcare has increased by 23 per cent to £80 million a year. Is that trend likely to continue?

Caroline Gardner: It is very hard to be definite about that. Obviously it is a relatively small sum in the context of the overall health service budget and a lot of it relates to specific circumstances in Lothian with regard to the board's problems with managing waiting times.

Tricia Meldrum might have more to add on this issue.

Tricia Meldrum (Audit Scotland): Lothian was one of the main areas in which we saw this increase, which obviously was to deal with the backlog of patients who were not being seen within the treatment time guarantee period and the waiting list targets. That was a particular pressure and, indeed, Lothian has recognised that it will continue to be a pressure this year and is working to increase its local capacity. We will continue to monitor the situation to see what impact that is having, but we are also aware of other boards that are experiencing capacity pressures and which are making use of the private sector. We will continue to keep a close watch on the matter.

Bob Doris (Glasgow) (SNP): That last response was quite helpful in demonstrating that the use of private health provision is not part of the Scottish Government's direction of travel but is about meeting very specific needs. A very small local example that I can cite is the problem with assisted conception at Glasgow royal infirmary, where those who did not get the service they should have received were given private sector healthcare without delay in a specific one-off intervention. It is important to put on record that this is not about any direction of travel but about one-off circumstances in which such intervention is the right thing to do.

I will pick up on some of my colleagues' assertions. First, we have heard repeatedly about squeezed and tightening budgets, and some of the waiting times figures have been presented as a consequence of that. I know quite a lot about NHS budgets, as I am deputy convener of the Health and Sport Committee. It is important to put on the record that NHS board budgets are being increased by 3.1 per cent this year and that there have been real-terms increases over previous years. NHS budgets are therefore not being squeezed and tightened, but there could be reprioritisation of NHS resources from, say, acute care to community care. Do you think that the pressures on the NHS are a result of squeezed and tightening budgets, or a result of increased demand and the reprioritising of resources within the NHS budget? The assertion is that the pressures are a result of squeezed and tightening budgets.

Caroline Gardner: I think that there is an element of both. We are very clear that there are rising pressures on the NHS because of an ageing population, healthcare innovations that cost more and factors such as increasing obesity, which gives rise to long-term conditions that affect the health service as well as individuals.

You are absolutely right that there is a commitment from the Government to maintain budgets for the territorial boards with real-terms increases. The increases for revenue budgets will be very small in future and we are seeing a significant reduction in the capital budget. I am reaching the same stage as the Prime Minister—I cannot see numbers without my reading glasses. The figures are set out in paragraph 2 on page 5 of the report. We tried to break down the figures very clearly.

We also know that healthcare inflation tends to be higher than general inflation. The Government's efforts to maintain the budget in real terms are clearly recognised, but the pressures from aspects such as drug and technology costs will increase the pressure within the health service, even against that background.

Bob Doris: That is really helpful. It gives a more nuanced view of the NHS's financial position, although when you mention—

The Convener: Sorry, but this is important for Bob Doris, given that he made a very significant comment. Can you make sure, Auditor General, that that is stated clearly on the record?

Caroline Gardner: Certainly.

The Convener: Did you say that it was a bit of both and that there were financial and tightening pressures as well as the other pressures?

Bob Doris: Convener, I think that we heard that, and if you would let me continue with my question—

The Convener: No, no, I am—

Bob Doris: Convener, do you want a supplementary to my question?

The Convener: Excuse me—I am chairing the meeting, Mr Doris. I just need to get the Auditor General's point on the record, and then we shall proceed.

Caroline Gardner: For the record, convener, our report is very clear that the revenue budget is forecast to increase by 0.6 per cent over the next three years in real terms, so there is a small real-terms increase. The report contains more detail about the breakdown between territorial boards and other health boards, and between the revenue and capital budgets.

The Convener: You mentioned that the capital budget was decreasing, and you have accepted that there are squeezes on budgets because of the inflationary pressures on the NHS. Is that correct?

Caroline Gardner: Our report aims to be as clear as it can be about the facts surrounding the budget.

The Convener: Okay.

Caroline Gardner: I can run through all of that if it would help, but there are both real-terms pressures from demand and a commitment from the Government, which is borne out in the revenue budget, with a small real-terms increase over the next three years.

The Convener: Right. Thank you.

Mr Doris.

Bob Doris: That was already on the record, convener. I will now try to develop a line of questioning, with your permission.

I will have to come back to the financial position of the NHS because I feel that perhaps the convener has yet again muddied the waters. Just for clarity, I note that there is a real-terms increase in the revenue budget, which is money that is spent directly on patients. You talked about a cut to the capital budget, Auditor General, but it is only fair to put on the record that that cut is in the context of a 26 per cent cut to the Scottish capital budget. I think that that provides balance, convener—I am sure that we are all hoping to do that and not have a one-dimensional view of the report.

I want to move on. I note that pages 36 and 37 contain information on waiting times targets, which were met or not met. I have a question on the information on page 37 under the "Inpatient/day case treatment time guarantee" heading and that under the "A&E" heading. I note that the figures were taken from a quarter that included winter months. I have no idea whether you will say that that factor had a significant impact on slippage in relation to waiting times targets, but I think that it is reasonable to ask about that for clarification.

Caroline Gardner: We picked the 31 March quarter because the report covers the NHS finances for 2012-13, with the year end at 31 March. Winter generally has an impact on all NHS targets. We will provide an update on that to you next month when we produce our report on the management of NHS waiting times.

Bob Doris: That is very helpful. What if we were to show the figures from a different quarter—one that did not include winter? We clearly need better management of winter resilience—I would say that that is perhaps what the figures show—and I hope that the Government is taking steps to achieve that. Could the figures in this particular quarter be skewed by the winter months?

Caroline Gardner: I do not want to speculate on that. As I say, we chose the period specifically because it coincided with the end of the financial year to which the report refers. More information will be available to the committee next month in our waiting times updates.

Bob Doris: Okay. We have heard talk of targets and how helpful they are—or are not. Do you believe that the NHS and the Government are wed to targets? I ask because some of my colleagues raised the matter during yesterday's health debate in the chamber. Already today, one colleague has said that it is terrible that targets have not been met, whereas another has said that the problem is the targets themselves. The Scottish Government said that it was reviewing the target on patients seeing a general practitioner within 48 hours because of the unintended consequences that that target may be having for patient access to GPs. Did you come across examples of other targets that are well intentioned but which are having unintended consequences for forward planning in the NHS?

Caroline Gardner: I do not think that it would be helpful for me to focus in on individual targets in that way. However, I can say that having information about the performance of the health service is very helpful. It lets those running health boards, us as auditors and the people who rely on and pay for the NHS to understand how performance is changing and where there may be problems that need to be tackled.

It is important that the Government continues its work to make the targets rounded and to focus on the whole system, rather than run the risk of bringing about unintended consequences by focusing on one area. It would also be useful to continue the thinking on linking the HEAT targets with the outcomes approach that the Government has adopted, which is generally recognised as a very positive development in focusing on the longer term. Thinking through those linkages would also be a useful way of anchoring the targets in the longer-term achievements that the Government is trying to promote.

Bob Doris: Page 31 of the report includes information on consultant, nursing and midwifery numbers. There are modest increases in relation to those posts, but there are increases in the vacancy rates, too. Will you provide more detail on that situation?

I have spoken before about workforce planning tools. I have suggested that, perhaps, NHS boards were not planning ahead as effectively as they could do—for example, in relation to the move from acute to community care and how quickly they could disinvest from one service and reinvest in another. Do the figures reflect an improvement in NHS boards' workforce planning and management?

Caroline Gardner: You are absolutely right about the complexity that lies under the figures—they are headline figures that are aimed at giving an indication of travel in the NHS. Questions about the application of the new workforce planning tool would be better directed towards the Government and NHS boards. We hope that the tool will have a long-term impact by matching staffing needs to the changing ways in which healthcare will be delivered in the future. I do not think that we see the evidence of that just from those figures at this stage.

Bob Doris: You quite rightly mentioned long-term planning. I am very conscious that, to date, £300 million has been spent through the change fund for older people in the NHS. I think that the spend will reach around £500 million before the fund is replaced and, I hope, mainstreamed into NHS board services. The other day we found out that there is a £100 million integration fund, and you have mentioned the integration of health and social care. In scrutinising such significant amounts of money, an issue for us is the ability to track the pound, see how it is used and consider whether that is the best way to meet the desired outcome. I am incredibly supportive of the initiatives, but I wonder whether your office has looked into whether the resources are being used in a way that provides best value, or whether that is something that you are likely to do in the future.

My take is that this is about long-term planning. The £80 million in the change fund for older people that will be spent this year is short-term spending. However, the question is what that does this year, and whether it feeds into a mainstream core budget for an improved or redesigned service in years 5, 6 or 7. Have you given any thought to how you would track that spending?

10:00

Caroline Gardner: Yes. We currently have a significant piece of work under way, which Angela Canning is managing, to look at the way in which the priority of reshaping care for older people is being progressed. As part of that work, we will look at the change fund. We are due to publish that work in March—

Angela Canning: At the end of January.

Caroline Gardner: Sorry—at the end of January next year; I think that the work will come to the committee after recess. There will be more information in there to allow you to investigate that issue.

We are keen to see not only how the funding is mainstreamed, but how the successful examples that have been achieved through the use of that money are spread elsewhere across Scotland so that the benefits can be delivered more widely.

Bob Doris: I look forward to that report, because I am hopeful that the change funds will deliver real difference in long-term planning. Until that is analysed and scrutinised, we just do not know.

Mary Scanlon (Highlands and Islands) (Con): I will continue on the same theme, Auditor General. Bob Doris referred to the diagram in exhibit 13. In the heading for paragraph 68, you state that

"boards needed more staff time and facilities to meet demand".

The theme of pressures in the system runs throughout the report.

Looking at exhibit 13, I was concerned at the increase in the vacancy rates. Over one year, there was a 21 per cent increase in consultant vacancies and a 57 per cent increase in nursing and midwifery vacancies.

Exhibit 14 also alludes to the pressures on the system, as it shows a five-fold increase in work done in the private sector. I do not have a problem with that as long as the patient is treated within the required time and given quality treatment; I simply note that it is a five-fold increase in one year.

I heard what was said about NHS Lothian. I am looking for the trends in the system, but I do not know whether 80 or 90 per cent of that increase could perhaps be accounted for by the situation in NHS Lothian or whether there is an underlying trend.

Over the page, paragraph 69 is headed:

"Spending on agency nurses increased by 62 per cent".

The three figures that the paragraph mentions all relate to one year. NHS Lanarkshire, for example, increased its spending on agency nurses from £13,000 to £344,000, while NHS Forth Valley increased its spend from £14,000 to £273,000.

With regard to the three figures that are highlighted on pages 31 and 32, is this just a snapshot, or is it an indication of a trend in the NHS? In particular, there is a significant increase in vacancy rates and in the use of agency and bank nurses, which we thought was going to be reduced—in fact, I would venture to say that that increase is probably against Government policy.

Are those significant pressures in the system? Will we be able to meet targets in future if those pressures continue, or are they just short term?

Caroline Gardner: We think that they are all early indications of the pressures in the system that we have been discussing and which are there for a range of reasons to do with increasing need, changing patterns of care and so on.

I will ask Gemma Diamond to come in with a bit more detail on the trends that we are aware of. The picture is complex, certainly with regard to the vacancy figures. Consultant and nursing staff vacancies have gone up markedly across the year, as you say, but so has the number of staff in post in both those categories.

There was a shift last year from 4,427 consultants in post to 4,531, and a small increase in nursing staff from 56,467 to 57,036. That is the background against which we are seeing more vacancies. There are differences in different parts of Scotland and in different specialties. In some specialties it is particularly difficult to recruit, not only in Scotland but throughout the United Kingdom, and, in some instances, globally.

I will make one point about bank and agency staff. Bank nursing can be quite a good way of meeting the need for flexibility—in hospital staffing especially—that everyone has to manage, and of bringing back into the workforce nurses who may have had a break to bring up their families or to do something else. Bank nursing can be very well managed to provide good flexibility by using staff who understand the NHS and the service in which they are working. Agency staff bring more problems and risks with them because they tend to be less familiar with the hospital and the ward, and with the ways of working.

We would not see bank nursing itself as a problem, but the rise in the use and cost of agency staff seems to be worth paying more attention to, although it is still a relatively small amount of money in the context of the NHS as a whole.

Mary Scanlon: I highlighted that

“Spending on agency nurses increased by 62 per cent in 2012/13”,

and I understand that there was an increase of around 500 staff in nursing and midwifery. It is important that we have an accurate record of these figures.

The notes on exhibit 13 state that 350 of those 500 staff were Scottish Prison Service staff who transferred to the NHS. Those are not new staff—those people were doing work, but their employer was the Scottish Prison Service rather than the NHS. That accounts for the majority of the increase in nursing staff.

Caroline Gardner: You are quite right, Mrs Scanlon—I am not trying to suggest that your question is wrong; I just wanted to put the figures in context.

Mary Scanlon: I felt that it was important to be accurate.

Caroline Gardner: I will ask Gemma Diamond to pick up on what we know about trends in those areas.

Gemma Diamond (Audit Scotland): Those are the key figures that we look for in the annual accounts so that we can see what is happening with the trend. This year, we saw a reverse in the trend that we had seen previously—certainly for agency staff—of decreasing numbers, as there was a large increase this year.

It is too early to tell whether that is a real change in trend or just a difference for one year. We will need to track those figures next year to see whether the trend continues and those signs of pressure remain, or whether action has been taken to change the situation.

We know that change in the way in which services are delivered takes a long time to put in place, so it might well be that there is no immediate reduction in those numbers. It is hoped that action that is taken now will reduce the trend in the longer term.

Mary Scanlon: So, you will be looking in future at those three areas—vacancies, agency staff and the five-fold increase in private sector treatment—in order to manage information on trends.

Having been a member of a health board in years gone by, and having looked at the Arbuthnott formula and the national resource allocation committee, I know that a lot of time has been spent on coming up with a funding formula for health boards. I am surprised, after 14 years of this Parliament, to see that you have highlighted in paragraph 58 that five health boards are not being given their NRAC allocation of funds.

The report states:

“These NHS boards have been under-funded by a total of £517 million over that period.”

If I was a member of one of those health boards—Fife, Forth Valley, Grampian, Lanarkshire and Lothian—I would be quite concerned that despite the use of a very sophisticated formula to allocate funding, over a period of time, my board had received significantly less and was, to use your own term, “under-funded”.

Is it fair to ask all those boards to meet their targets and break even at the end of the year when they are being “under-funded”, according to your report?

Caroline Gardner: That is an area that we look at closely each year, for exactly the reason suggested by your question. It is important to say that we are talking about underfunding against the formula allocation, rather than in absolute terms. However, in principle, if the allocation formula is there, we would expect to see movement towards it over a period of time.

We have said, both last year and this year, that there is no clearly discernible pattern that links a board’s financial performance and its distance from the resource allocation formula. We say that at paragraph 59 of the report. Some boards that are below allocation do very well, and some seem to be struggling, and we would like to explore that further in future years. The committee may also wish to explore that question, either with the boards themselves or with the Scottish Government.

Mary Scanlon: You say that there is a "lack of clear plans and an agreed timescale to move towards parity".

Will you look to the Scottish Government to ensure that those boards are given their recommended allocation? I am quoting from the end of paragraph 58. You say that that

"adds uncertainty to NHS boards' planning."

Are you asking the Government to look towards a timescale in which the boards could receive the recommended allocation of funds?

Caroline Gardner: It is entirely appropriate for the committee to explore with the Government what its plans are for movement towards the formula. The point that we tried to make is that such things add uncertainty to boards' overall financial planning. That fits within the context of our recommendation to strengthen that area.

Colin Beattie (Midlothian North and Musselburgh) (SNP): First, we should note the good performance of the NHS and the Scottish Government in managing the NHS's finances in such a tight way at a very difficult time. There are undoubtedly challenges for the future, but every organisation faces those.

Ms Scanlon took my question, but I have another one on pension fund liabilities. Paragraph 84 of the report mentions pension fund liabilities in relation to NHS Highland. Perhaps I missed it, but I did not see anything about pension fund liabilities in the NHS as a whole.

Caroline Gardner: There is something in the report about pension liabilities for the NHS as a whole, which I will ask Tricia Meldrum to point me towards in a moment.

We specifically referenced Highland in paragraph 84 because of the challenges that are thrown up by the approach that has been taken there to health and social care integration, which the auditors, the health board and the council have had to work through over the past 12 months. We hope that that will provide some useful learning as health and social care integration progresses.

Tricia, can you point me towards the more general reference?

Tricia Meldrum: Paragraph 64 on page 30 and the bullet points above that reiterate the points in last year's report about NHS pension funds.

Caroline Gardner: The challenge is that there has been a delay in the pension fund revaluation over the past couple of years. Since the publication of the report, that may now be closer to being resolved, but we made the point last year and again this year that having up-to-date valuations of the liabilities is important if we are to manage the pension scheme, the contribution levels in the future and the associated risks.

Colin Beattie: Recent revaluations under the new accounting rules in other areas of the public sector, which take into account the reduced bond yields, have resulted in almost 100 per cent deficits right across the country. I presume that we can expect the same for the NHS.

Caroline Gardner: I think that we discussed this a few weeks ago in relation to college pension schemes. You are correct that, in revaluations, very small movements in the discount rates and the new accounting rules can have significant impacts on the liabilities. That is why it is important that a revaluation should be carried out for the NHS pension scheme and the other schemes that are affected by the Treasury's moratorium on revaluing over recent years.

Ken Macintosh (Eastwood) (Lab): I apologise if this goes over some of the ground that has been covered, but I ask for clarification at the risk of inviting Bob Doris to intervene again. Am I right in thinking that the main conclusion is that demand is increasing but it is forecast that the overall health budget will fall in real terms?

Caroline Gardner: It is true that demand is increasing for a range of reasons. In the first part of the report—on pages 5 to 8—we tried to put on the record what is happening with NHS funding, which is complex. Against a backdrop of very tight financial resources for the Scottish block as a whole, which are the result of decisions that have been made elsewhere, the Government has made a commitment to protect the budgets of the territorial NHS boards in real terms. We expect that to be the case over the next three years, with a small real-terms increase of 0.6 per cent over that period.

The exhibit on page 8 shows in cash and real terms what is happening for the special and territorial health boards. It shows very small real-terms increases for the 14 territorial health boards over the years to 2015-16 and varying decreases for the special health boards. There is therefore a complex picture for those two types of board: there is a real-terms increase in revenue spend but a real-terms decrease in capital spend. We hope that our reports in general provide a clear and independent picture of the movements in finances over a period.

10:15

Ken Macintosh: That is helpful. Clearly, there are pressures and priorities in the health service spend. Is overall health spending forecast to decline in real terms over the next three years?

Caroline Gardner: We say as clearly as we can in paragraph 2:

"The overall health budget is forecast to decrease by 1.6 per cent in real terms over the next three years ... The revenue budget is forecast to increase by 0.6 per cent ... while the capital budget is forecast to decrease".

Within that, the territorial health board budgets go up and the special health board budgets go down.

Ken Macintosh: That means that health spending, whether you divide it into capital or revenue, is going to fall in real terms while demand is going to increase. Is that correct?

Caroline Gardner: I do not think that it is helpful for me to simplify it in quite those terms. The headline figure for the overall health budget is clearly an overall decrease of 1.6 per cent. However, when those figures are broken down there are very real differences between the territorial health boards and the special health boards. Within the special health boards, there is a distinction between those that provide patient services, such as NHS 24, and those that provide support services, and there is a real difference between revenue and capital. People will have different interpretations of the most important feature of that. All that I can do is replay the detail in a way that is as independently based as we can make it.

Ken Macintosh: I want you to clarify something that was commented on earlier. Exhibit 14 on page 31 is striking, as it shows that there has been an increase in spending on bank and agency staff and quite a dramatic increase in spending on private sector healthcare. Does that really represent good value for money?

Caroline Gardner: The increase in both those areas is significant, but it is against a very small base and we are talking about an NHS budget of about £12 billion. For example, the increase last year for private healthcare provision was £14.8 million, which is a very small proportion of the overall budget. The Government has made it clear that its approach is not to prioritise spending on private healthcare provision, but to use that provision where there are problems such as Tricia Meldrum has highlighted, in places such as Lothian, in meeting wider healthcare delivery targets. The question of how that is being managed is better directed towards the health boards concerned and the Scottish Government.

It is absolutely true that there has been an increase in those areas, but it is against a small base and it is still a small number within the context of the NHS budget as a whole.

Ken Macintosh: Thank you. I turn to another issue entirely that has been brought to my attention—I could not see it in the report, but you might be aware of it. It is a particular example from NHS Tayside. I am not sure whether it was called a revaluation, but it involved the handover of the assets of non-profit distributing organisations to the health service in 2012. There was a project for the Susan Carnegie centre at Stracathro hospital that had contract costs of £18.4 million and there was a project at the Murray royal hospital site in Perth that had costs of £77.1 million. The facilities cost £95.5 million, but when they were handed over to NHS Tayside they were revalued at £83.4 million. In other words, they lost more than £10 million in value because they were revalued at £10 million less than they cost to build. Would that emerge somewhere in the NHS accounts? Would you audit that?

Caroline Gardner: From paragraph 26 of our report onwards, we talk about the accounting adjustments that are required for public-private partnership projects of various types. I think that the Murray royal hospital is referred to within that, but the Stracathro treatment centre is not. Gemma Diamond is our expert on that, so I ask her to talk you through the position in broad terms. We can provide any other information that is necessary afterwards.

Gemma Diamond: The figures will appear in NHS Tayside's accounts. The auditors at NHS Tayside raised the issue of the impairment on the valuation in their annual audit report to the board and to the Auditor General. The auditors recommended that the health board work with the Scottish Government to discover why that had happened, and they will follow that up as part of their audit this year. We will look at it next year to see what action has been taken and whether any wider issues arise beyond the issue for NHS Tayside.

Ken Macintosh: Were you surprised to see such a big project lose more than 10 per cent of its value like that? Would you expect to see that? Is that normal practice in the NHS?

Gemma Diamond: We do not have the details to know how the evaluation was arrived at. The auditors assessed the evaluation with the board and have asked the board to look into it and see whether any wider implications for other NHS boards arise from the valuation. We will have to follow that up over the next year, and the auditors themselves will follow it up.

Ken Macintosh: Have any other NPD projects or other construction or capital projects been similarly revalued or asset impaired?

Caroline Gardner: There are a number of PPP projects in the NHS and some new ones are coming on stream. It is something that the auditors routinely keep under review as part of their annual audit work. As Gemma Diamond said, the auditors will report both to the health board and to me, as the Auditor General. If significant issues or a trend were identified, I would certainly consider reporting that to the committee, but that has not been the case so far.

Ken Macintosh: If the NHS Tayside situation was more than a one-off and developed into a trend, you would expect us to be alerted to it.

Caroline Gardner: I would alert the committee to any significant financial issues that came out of my areas of responsibility in the NHS and the wider public sector. However, so far, that has not been the case.

Ken Macintosh: What would be the next course of action in the NHS Tayside situation? It has been reported by the board. Would we expect the Government to intervene in some way and to report to Parliament? Would we expect Audit Scotland to be involved? How would the situation be accountable in a parliamentary manner, or would it not be?

Caroline Gardner: As I said, if an issue is significant enough to bring to the attention of the committee, I have the reporting powers to do so either through the section 22 powers to report on a board's annual accounts or through a section 23 report like the one that is before you today.

Ken Macintosh: I would have thought that, in these times of tight budgets, the loss of £12 million on a building project is the sort of thing that the committee would want to know about.

Caroline Gardner: I am not sure that it is accurate to characterise the situation as the loss of £12 million on a building project; it is about the valuation of the asset and the accounting adjustments that follow from that. However, I will look at what we heard from the auditors in relation to the previous financial year and will consider whether there is an issue that would merit further reporting.

Ken Macintosh: Can you clarify what it means? If a project is built at a cost to the public of £95 million and then appears in our books at a cost of £83 million, is that not a loss of £12 million?

Caroline Gardner: No.

Ken Macintosh: What is it then?

Caroline Gardner: Accounting adjustments are required, and without knowing the reasons for the variation—which, as Gemma Diamond said, are being explored between the health board and the Scottish Government and will be reported on further by the auditors—I do not want to speculate on what the underlying cause is.

The Convener: If there are any further issues of clarification on that, either the member or the committee can write to the Auditor General. I intend to finish this session at half past 10, so I will cut questioning on that issue now. Is there anything to add on it?

Ken Macintosh: No.

The Convener: I would like you to clarify something, Auditor General. You referred to PPP projects being mentioned in paragraph 26 of the report. Are such projects still being developed?

Caroline Gardner: The acronym PPP is used to refer to a range of privately funded projects, including the non-profit distributing model, the private finance initiative and so on.

The Convener: Okay. The impression is sometimes given that PPP was abolished, but such projects still exist.

Colin Keir (Edinburgh Western) (SNP): I will leave the obvious discussion about the financial pluses and minuses because I think that we have had enough of that.

NHS Lothian is mentioned in several parts of the report, including in respect of the problems with recruitment, which you have explained quite well and which I understand. I was aware that some specialist areas were struggling to recruit, but that is the case not just in NHS Lothian but UK-wide. I believe that NHS boards are having to advertise as widely as the far east to fill particular positions.

Three of my colleagues have stolen most of my intended questions, so I will ask about what I am left with from my notes on what interested me. Given NHS Lothian's problems over the past year or two, have the accounting mechanisms been improved to a state that would allow us to feel confident about where NHS Lothian is going in its financial performance?

Caroline Gardner: I ask Gemma Diamond to come in if she wants to add anything to this. NHS Lothian's financial statements have been audited every year, as all health boards' financial statements are. There have been some recommendations for improvements in financial management in NHS Lothian, but nothing significant or out of the ordinary run of things across the NHS. We saw particular problems in the management of waiting times, which were reported on extensively last year, and we will provide an update on that issue right across the NHS. However, the recommendation for NHS Lothian in particular to improve longer-term financial planning, underpinning it with strong forecasts and strong scenario planning, is all the more important because of the pressures that it has faced in the past. There are no differences in its accounts or financial management, but there is a difference in the underlying pressures that it is having to manage.

Colin Keir: Have you found any other weaknesses in NHS Lothian's reporting mechanisms that have not been addressed? I feel as though I am picking on my local health service but, given the problems that NHS Lothian has had, it is important that we all feel confident in the new management regime's ability not only to address the problems with waiting times in the past, but to produce comprehensive and, frankly, trustworthy reports in the future.

Caroline Gardner: In NHS Lothian, there has been a real focus on earning back the public's trust and confidence. Its annual accounts received a clean audit certificate this year, as did those of all other health boards. I know that you are interested in more than waiting times, but the work that we are finalising now on progress against our waiting times recommendation shows that NHS Lothian has made a really strong effort to improve the information that is going to the board to enable it to monitor that. We can take that as an indication that NHS Lothian is responding positively to the challenges that it has faced over the past few years.

The Convener: Thank you. I am going to finish this session at 10.35. James Dornan is next to ask a question.

James Dornan (Glasgow Cathcart) (SNP): Auditor General, I share your frustration about some of the blatant politicking going on at this meeting.

Can I take you back to the workforce figures that we were talking about earlier? Mary Scanlon mentioned the figures for nursing and midwifery. My partner is a nurse and I know that 10 staff have just been hired on her ward, with more meant to come on in the very near future—that is just one personal example. Do you think that these figures are a one-off? Are they part of an upward trend, or could the number of vacancies decline?

Caroline Gardner: First, I am sorry if any of my words or my body language has indicated frustration with members. Clearly, I am here to respond to questions that members might have on the work that we produce.

As Gemma Diamond said, we monitor the question of vacancies very closely through the annual accounts and more widely. We work closely with the Scottish Government to look at the financial monitoring and performance monitoring between the Scottish Government and health boards. It is simply too soon to say what is happening there. There are indications of pressure that we think that the Government and health boards should take seriously, and there is a range of ways in which they can respond to those, by redesigning services and focusing on longer-term financial planning to be able to square the circle of increasing demand and very tight resources.

James Dornan: Nobody welcomes any increase in agency staff but, again, I know that nursing staff are being asked about their bank staff availability, so there seems to be a push in the health service to try to use bank staff again. Do you have any indication that we will see a decrease in the use of agency staff and, as I hope, an increase in the use of bank staff?

Caroline Gardner: I have been resisting all morning the temptation to use that famous quotation from Niels Bohr, the physicist, that prediction is always hard, especially about the future. We simply do not know the position yet. Our strong view as an organisation is that bank staff are better than agency staff as a way of responding to short-term fluctuations but that that is what they should be used for, not filling gaps for the longer term. We are seeing significant work going into workforce planning, but it is early days yet to see the results of that. However, it is something that we will keep under close review. The committee might want to explore that further with health boards or the Government.

James Dornan: Thank you.

10:30

Willie Coffey (Kilmarnock and Irvine Valley) (SNP): I will start by picking up on the point about accident and emergency targets, which are described on pages 36 and 37 of the report. In his opening remarks, the convener talked about significant failures, but my understanding of the information is that there have been significant successes. The accident and emergency target column in exhibit 15 shows that most health boards met or were within 5 per cent of meeting their target. That is a different message from the message of "significant failure" that the convener opened with. For two of the health boards in particular—Ayrshire and Arran, and Lanarkshire—I shudder to think what would have happened and what figures we might have got in this report had Ayr and Monklands hospitals shut.

Auditor General, in your opening remarks, you talked about the need for detailed planning and said that it was not being done on the affordability of plans. I want to pick you up on what that might mean. Your report refers to brokerage and flexibility arrangements on a year-by-year basis. Can the boards deploy a brokerage and flexibility mechanism to help them with that detailed planning, or are we stuck rigidly to the annual financial planning that you recommend we should move away from? Do you recommend that we should continue with the flexibility mechanism and, if so, does that mean that we do not need rigorous annual financial targets to be set?

Caroline Gardner: There are at the moment, as you said, very rigorous annual targets, and health boards and the Government take very seriously the need to meet those. That is good in terms of financial discipline, but we think that it can get in the way of the longer-term financial planning that is needed to find more sustainable solutions to the pressures that the health service is under. At the moment, brokerage and other short-term flexibility are the way in which those targets are hit. To come within 0.16 per cent of the targets across the NHS as a whole is not done by chance; it is done by very close monitoring month by month and moving money to where it is needed. Again, that is entirely understandable within the framework that we are working in.

We reported last year that those movements were not transparent, but we think that there has been a real improvement this year in boards' annual reports and accounts in making that more transparent for revenue, although we think that there is still more to do in relation to capital. However, we still think that there is a danger—I think that the cabinet secretary and the Scottish Government now share this view—and that it would be helpful to move away from the annual framework to something that gives a longer-term planning horizon.

Our view is that, within that horizon, the ability to respond to the pressures would be strengthened by much more detailed financial planning and scenario plans that look at different possible states in the future and different ways of providing services and so on. It is all about marshalling the best of the NHS to ensure that it can continue to meet people's needs as we all get older as a population and as our needs change. It seems to us that, on balance, the annual financial frameworks get in the way of that flexibility, so we are pleased to hear that the Government is considering ways of moving away from that to something that provides a longer-term planning framework.

Willie Coffey: I am very encouraged by that. Thank you.

As time is short, I will move to my next question, which is about opportunities for recurring savings. Exhibit 10 on page 23 shows that the biggest return was in the drugs and prescribing area, partly from savings made from drugs coming off patent. Are the savings a trend that is likely to continue, or is the situation likely to get worse? There have been some quite impressive savings for the NHS in the past year or so. Can we expect to see that continue?

Caroline Gardner: I will ask Tricia Meldrum to come in on the detail on that, but you are right that drugs have made a significant contribution to savings. The important point that we highlight that boards need to be aware of is that that is very much affected by specific drugs coming off patent and being available in generic forms that are much cheaper. That tends to happen in chunks, so there is a significant saving in one year from a drug coming off patent, but we cannot rely on the same thing happening on a regular basis. Tricia Meldrum will add a bit of context to that.

Tricia Meldrum: In 2012-13, atorvastatin, which is one of the most popular statins, came off patent. It is widely prescribed and used by a lot of people, so that is one of the drugs that have had a significant impact on savings. There will not be quite the same level of potential savings from other drugs coming off patent in the near future, but we are aware that the Government and the boards are carrying out a lot of work on this and are continuing to look at improving the quality and cost effectiveness of prescribing. For example, a national workstream is examining national therapeutic indicators and seeking to identify a small number of drugs and types of drug on which attention can be focused. However, we do not expect to see the same level of recurring savings as we saw in 2012-13, as much of that was down to atorvastatin.

Willie Coffey: As a very brief—and, I hope, final—point, surely the system must know which drugs are coming off patent in the next one, two, three, four, five or even 10 years. Is the NHS able to build that into its financial planning forecasts? Previously, good progress was made in using generic rather than brand drugs and I think that that trend should be welcomed. Do we, as I think the Auditor General mentioned earlier, build that into our forecasts?

Caroline Gardner: Yes, and you are right to say that it has been a significant success for the NHS. However, our point is that atorvastatin is a real one-off because of the extent to which it is used in the health service, and it is hard to spot another drug that will have as significant an impact on the budget when it comes off patent.

The Convener: Before I close this evidence session, I want to come back to Willie Coffey's point about my comments on accident and emergency. I hope that I have not misinterpreted anything, so I ask the Auditor General to state for the record the health boards that met their A and E targets.

Caroline Gardner: We have tried to make the exhibit in question as clear as we can, convener. The four board marked with a green tick all achieved four-hour waiting times for A and E and the boards with two yellow arrows came within 5 per cent—

The Convener: I am sorry, but could you just list for the record the names of the boards that met their targets?

James Dornan: It is on the record.

Caroline Gardner: I am reluctant to interpret this complex exhibit on the record because of the focus that is being placed on this particular number. It might be useful if I write to you to place that on the record. As you can see, a number of indicators in the column in the exhibit have quite specific meanings and I want to ensure that we do not mislead the committee about what they mean. I am certainly very happy to follow that up.

The Convener: That would be helpful because, as presented, the exhibit indicates that Orkney, Shetland, Tayside and Western Isles met their target. It would help if you could clarify what the overall statistics mean to ensure that we are not under any misapprehension about their significance.

Willie Coffey: Convener, I said that most—

The Convener: I am sorry, but I must thank the Auditor General and her staff for their evidence. No doubt we will follow up the issue at some point.

I suspend the meeting for a couple of minutes for a changeover of witnesses.

10:37

Meeting suspended.

10:41

On resuming—

"Scotland's colleges 2013"

The Convener: Item 3 on the agenda is an evidence session on a section 23 report, "Scotland's colleges 2013", on which we have previously taken evidence from the Auditor General and Audit Scotland.

I welcome to the committee our first panel of witnesses: Audrey Cumberford, principal and chief executive of West College Scotland; Margaret Munckton, acting principal and chief executive of Perth College; Susan Walsh, principal and chief executive of Glasgow Clyde College; and Alan Williamson, director of finance at Edinburgh College. I am not sure whether this is a direct interest but, for the avoidance of any potential conflict of interest, I declare that my wife is a member of the West College Scotland board.

Before we get into the detail of the report, I want to ask about the title "principal and chief executive", which now seems to be common currency. Why is your title not "principal" or "chief executive"? Why are both titles used?

Susan Walsh (Glasgow Clyde College): It is very simple. The emphasis in incorporation was on colleges operating in a businesslike fashion: principals who previously were responsible only for an institution's academic element changed their role and, as a result, their title was changed.

In other words, the title has become the tradition since incorporation. The chief executive element is supposed to highlight that we are now responsible for the college's financial wellbeing and the wellbeing of our staff and resources. You will probably find that, over time, the chief executive element will diminish.

The Convener: That was an interesting response; indeed, it raises a number of other questions.

The further education sector is facing real challenges. We have heard a lot of competing and contending comments about that, but, according to Audit Scotland, a reduction in Scottish grant funding of £56 million in real terms compared with 2010-11 contributed to a 9 per cent fall in colleges' overall income.

Given that 9 per cent decrease between 2010-11 and 2011-12 and the further 11 per cent reduction in real terms between 2011-12 and 2014-15, can you all say that you are able to deliver the same level and quality of service to the same volume of students? Has there been any significant change to what you do?

10:45

Audrey Cumberford (West College Scotland): There has absolutely been an impact, but there is a difference between the level and amount of activity vis-à-vis the quality.

Over the period that you have just mentioned, enrolments in the three constituent colleges that make up the new West College Scotland reduced by approximately 10,000, so there has been a reduction in the number of people attending the college. There has also been a reduction in the range and level of the provision that we are able to deliver. With regard to quality, however, our performance indicators are increasing, and quality remains a key focus for West College Scotland as we move forward.

The Convener: So there are fewer students attending, but for those students the quality has not been affected.

Audrey Cumberford: Yes.

The Convener: I want to ask about one thing that I am not quite sure about, which is why particular colleges were brought together and what the significance of that is. However, before I ask that, does anyone else wish to comment? Does Audrey Cumberford's answer apply to you, too?

Susan Walsh: Yes, it probably applies across most of the sector, although geographical differences must be taken into account.

We have expanded the level of provision with regard to the Scottish credit and qualifications framework to allow students to access degree programmes in one of the Glasgow Clyde College campuses. In terms of local access, that benefits students.

As Audrey Cumberford mentioned, the quality has improved in the past year. Cardonald College, which is now a constituent part of Glasgow Clyde College, had no points for action in its latest Education Scotland review. That is not a common occurrence, and I must praise the teaching and support staff for supporting students and allowing that to happen.

The issue of volume is a question of definition, as understanding varies as to what constitutes a full-time student and a full-time equivalent. In terms of enrolments, which is the number of people who walk through the doors of the college, Glasgow Clyde College would—if it had existed since 2009—have 14,700 fewer enrolments today.

The Convener: Right—that is 14,700 in comparison with the number of enrolments in the colleges that amalgamated.

Susan Walsh: Yes—the colleges that amalgamated to form Glasgow Clyde College.

With regard to the cohort of students, the age profile has dropped and we can track the differences in percentage attendance between the different age groups: 16 to 19-year-olds, 19 to 24-year-olds and 24-year-olds plus. The biggest drop is in the number of students who are aged 25-plus.

The Convener: I want to explore that, because the 25-plus age group is quite significant.

Looking at some of the recent news, we do not know what the future of our shipyards in Glasgow might be, and in Paisley—as Audrey Cumberford will know—BASF recently indicated that it intends to cease production. There are one or two other manufacturing companies, and other companies, that are going out of business. That means that those who are affected by redundancy, unless they are nearing retirement, need to think about reskilling and retraining. They would not necessarily fit into the under-25 age group.

What is the impact on those who need to retrain or reskill because of job loss, given that—as Susan Walsh said—amalgamation has had a significant impact on attendance in the 25-plus age group?

Susan Walsh: Some of the issues relate to whether there is demand or need. Some of the reduction in numbers is down to people choosing not to come to college, probably because our sector has not had particularly positive public relations in recent times. Some of it is down to the focus on 16 to 19-year-olds. We welcome that focus and understand that young people need an opportunity, and that the earlier we can provide education for people, the more a positive benefit comes back to their families and to the economy.

The issue has been around the fact that, where we have offered programmes previously, we might have reduced the number of times in a year that they are offered or the number of opportunities that are offered. For people who are in jobs, attending a college has always been a way of enhancing their qualifications while still earning. Perhaps the instability in the economy has meant that people have chosen to stay in jobs and are not focusing on their education as well. There are also issues around fees, as people have to pay for training. From that perspective, it is about people choosing not to come and colleges unintentionally but necessarily limiting some of the opportunities that are available.

When we consider specific things such as the situation with BAE Systems—my college is very much involved with that company—we need to look at how we work in partnership with other organisations such as Skills Development Scotland, perhaps through the partnership action for continuing employment programme, which helps people to deal with potential redundancy situations. It is flexibility in funding that will allow us to do that.

The Convener: You mentioned people improving their qualifications while they are working. In a previous experience, I was a teacher, and while I was teaching I was also a lecturer at one of the Glasgow colleges in the evenings. The people who attended those classes were all people in full-time employment who wanted to add to their skills and qualifications. Are those types of classes affected?

Susan Walsh: I can speak only for my college, but we have certainly seen a reduction in the number of classes that are offered in the evenings. At one point, a local FE college might have been open for four or five evenings a week. As part of our response to our budget cuts, we have looked at trying to concentrate facility use, and that has led to a reduction in access in the evenings. That makes it harder for people who are in full-time employment to go and upskill.

Audrey Cumberford: The profile of the portfolio of colleges has shifted in response to both the cuts and Scottish Government priorities. Colleges are good at responding to the priorities of the Scottish Government of the day, but there has been a shift to full-time education at the expense of part-time education.

The Convener: Thank you. We will now have questions from Mary Scanlon.

Mary Scanlon: Like the convener, I am a relic—if you like—of further education, as I lectured there before coming here. I am delighted to see three female principals here today.

I have three short questions. First, I refer to pages 18 and 19 of the report. The teaching budget has fallen by £69 million over two years. There are 48,000 fewer students, which represents a 16 per cent fall—that is in paragraph 32—and the number of part-time students has fallen by 40 per cent. It is tragic that potential mature students are not finding access.

I refer to an aspect of Scottish Government policy that we all support: the Wood report. Given all the cuts and the reduction in the courses that are available, given that the age profile has dropped, and given what you said about the limiting of opportunities, if the approach under the final Wood report, which we expect at the end of the year, is to work, will the colleges be able to respond to the need for vocational education for—I think—over-14s? Will you be able to meet the challenges that are set in the Wood report, given the serious cutbacks in provision, head count and finances in recent years?

Audrey Cumberford: The strong answer to that is yes: we can respond, and colleges have to play a key role in responding to the Wood report. However, there is a “but”, which is that the resources that we have are for our current activities.

If we are looking to put in additional activity in response to the Wood report, the resource will have to come from somewhere. Either that activity will have to replace activity that is under way—assuming that we are all delivering to our maximum capacity for activity, which we are—or additional resource will have to come into the sector to facilitate that additional activity.

There is absolutely a willingness in the college sector to respond. Indeed, it is already responding to and delivering on many of the interim report’s recommendations.

Margaret Munckton (Perth College): We also see that we can do a very effective job in replacing some of the existing provision that we already deliver. For example, we want to strengthen the senior phase curriculum under the school-college partnership. We want to enhance what the increased number of school pupils are doing, particularly in their sixth year, by enhancing the range of provision.

Some of the displacement that Audrey Cumberford mentioned can be done within the existing school-college partnership arrangements, although we rely on the schools to meet us and work to the same end—the more delivery that we do in the senior phase, the greater the negative impact will be on the utilisation of school staff. We are just being realistic in saying that.

On modern apprenticeships, we bid for additional funding annually through the SDS mechanism. The fund is drastically oversubscribed every year. It would be a bonus to us and to Scotland if a more strategic approach was taken to the allocation of the funding in line with Government priorities.

Mary Scanlon: I was in Inverness College on Friday to see the school pupils. A wonderful model is used there—one that every party supports. Are you saying that the SDS funding is limiting what you can do on modern apprenticeships? Bearing in mind that 77,000 are not in education, employment or training, is the budget limiting what can be done?

Margaret Munckton: It is absolutely limiting what can be done. The annual bid process is oversubscribed every year. Perth College has been denied for the second year running any funding for hospitality students, and yet tourism is not only a Government priority but a particular priority for Perth and Kinross.

Mary Scanlon: I am sorry to hear that. I realise that all my colleagues want to come in on the issue, so I will briefly ask my second question, which is probably for Margaret Munckton to answer.

I represent the Highlands and Islands, where a different model from that of mergers and regionalisation is used. I am concerned about what is often referred to locally as the top-slicing of the budget by the University of the Highlands and Islands before it comes to colleges.

I am concerned that you are perhaps being asked to do more with fewer funds with regard to teaching. I appreciate that the quality is still excellent but, because there is no merger, there can be no economies of scale and you will not be able to achieve similar savings. Does the £15 million cost to run the UHI’s administration and its 200 staff put the colleges in the Highlands and Islands at a financial disadvantage compared with other colleges on what you can spend per student?

Margaret Munckton: I am not sure about the comparison between Highlands and Islands colleges and the rest of Scotland on a per capita resource basis because our higher education is funded differently. However, although it is not easy to draw that direct comparison, it is fair to say that any amount of top-slicing reduces the money that is available for front-line delivery.

In recent years—since the university has achieved growth targets—we have been able to increase slightly the unit of resource that comes to the colleges to pay for learning and teaching. That is not to say that the size of the central administrative office is acceptable; indeed, it is still growing.

The issue was the subject of a Scottish Further and Higher Education Funding Council report by Capita—we refer to it as the Capita report—and the report gave clear recommendations. Progress against those recommendations has not been as rapid as any of the partners would have wanted to see.

11:00

Mary Scanlon: I understand that that report came out two years ago. Even if you received the same funding per student, as Tavish Scott will also know, we do not have in the Highlands the critical mass in numbers that your colleagues Audrey Cumberford and Susan Walsh enjoy, and the class numbers are often smaller. It would be a sad day if those courses were to leave. Perhaps we will pursue that later.

Margaret Munckton: We have recently done an analysis of data as part of our regionalisation. The class sizes for further education across the Highlands and Islands region vary from nine in Orkney, I believe, to 28 in Perth.

Mary Scanlon: I will go on to my third question.

I have met various college principals lately. For colleagues, I refer to part 3 of the report and paragraphs 67 to 69, on the reclassification of colleges. This may be an opportunity for Mr Williamson to come in.

We have just heard the Auditor General say that she wants to get away from NHS boards having to balance their budgets every year, but we are now finding that colleges will have to balance their budgets every year, which seems to stifle your ability to use funds.

At the beginning, Susan Walsh said that colleges have behaved “in a businesslike fashion”, which they have done since the 1990s. Does the Office for National Statistics reclassification mean a loss of autonomy? Will becoming a Government department help to grow the colleges?

I wonder why you are being treated differently from universities and why you are not being allowed to build up reserves. You will not be able to do any commercial work, and I understand that your financial year will change from being the student year, which has always been the case, to the fiscal year. How will you cope with the reclassification to a Government department rather than being what we have always seen as autonomous bodies that have been able to react and respond to local economic pressures?

Alan Williamson (Edinburgh College): I think that, across the sector, most would have preferred the ONS reclassification not to come in.

Mary Scanlon: I understand that, in England, legislation was brought forward to prevent it from affecting colleges, but that was not done in Scotland.

Alan Williamson: Yes, because the classification tends to limit the use of surpluses and similarly the use of any reserves. However, it is about to happen, and we are looking at mitigating arrangements and working as best as we can through the imminent changes.

Mary Scanlon: I understand that you are setting up arm’s-length trust organisations in order to overcome that. Am I correct about that? Will you expand on how that will happen?

Alan Williamson: That is right. There were two options. The funding council offered to set up an umbrella trust that most of the colleges could join, if they wanted to, but some college boards decided that they would prefer to set up their own trust, as that might give them more flexibility in what they could do.

The key criteria for setting up those trusts are, of course, independence and dominant influence. The independence is very much on the legal side. A body can be legally set up as an independent development trust, but that needs to be passed through the auditors to ensure that there is no conflict on the dominant influence side. The dominant influence side means that the accounts of both organisations need to be consolidated, so any surpluses or reserves will be captured in the same way as they would be under the ONS reclassification.

Mary Scanlon: How confident are the principals about the flexibility? Will you be able to continue as you have done in the past? Do you think that the new concept will stifle what you are doing? What change will the reclassification bring for colleges that currently have loans from banks, for example, or even PFI projects? Is it a cause of concern?

Audrey Cumberford: In West College Scotland, 21 per cent of our income comes from other sources. That income is critical for strategic reinvestment in what we do and in enhancing our provision, resources and estates. To take that strategic perspective, that is where the challenge is with ONS in moving to an annual cycle.

It is fair to say that there are still some unknowns. Colleges are either pursuing their own regional solution via arm’s-length foundations or moving towards the national umbrella trust and working closely with lawyers and internal and external auditors on responses to the questions that you have just asked. It is fair to say that we do not have all of the answers to those questions.

Mary Scanlon: I understand that the reclassification is to be implemented on 1 April, so we are running short of time. The 21 per cent that is coming from other sources is commendable but in relation to your college, Audrey, how will the reclassification affect that?

Audrey Cumberford: The effect will be on generating reserves. Our view is that it is important to be able to generate reserves to reinvest back into the college for the benefit of our students, local communities and staff. The public funds that we currently receive pretty much just cover the payroll bill. We have to do everything else by ourselves and by generating income from other sources.

Mary Scanlon: So the reclassification will stop you from generating income from other sources.

Audrey Cumberford: It will not stop us doing that, but it means that we will have to reinvest annually. That does not allow for strategic planning and investment, which are important.

Mary Scanlon: I will just leave it there. We could go further.

The Convener: I would like some clarification on the arm's-length trusts that you all seem to be exploring. Will they be completely independent? If they are, to whom will they be accountable? How will there be accountability for funding that is either transferred to or generated by those arm's-length trusts? How will you guarantee benefit to the college from an arm's-length trust over which you potentially have no control?

Margaret Munckton: There will be no guarantee. We are going with the work of the SFC, which is acting as the main adviser to the sector on this. We need to do it in order to preserve our ability to invest in our facilities, students and staff. It needs to happen or we will be a poorer sector.

The Convener: I understand why you are doing it and that you could otherwise be, as you describe, a poorer sector. I am interested purely in accountability and the money lines. Where does the money come from and where does it go? How is the money used and who assumes responsibility?

Even if you go with the umbrella trust that the SFC is promoting—I presume for the same reasons that you described in relation your own possible arm's-length trusts—that umbrella trust would also need to be completely independent of the funding council. To whom would it be accountable? If it were to operate Scotland wide and money were generated, for example from Perth College or West College Scotland, and went into the trust, how would you know that the money was coming back to be spent in your area? Could you control that?

Margaret Munckton: We have replied to the funding council that the single umbrella trust for Scotland is Perth College's preference. We would therefore rely on that umbrella trust being set up as we been informed it will be set up. Our understanding is that the money will be partitioned. Because 44 per cent of our income is generated outwith the public funding, it is highly likely that we will need to put money in annually rather than being forced to spend it as we generate it within the year. It is vital to us that the money that we generate in that way comes back to Perth College. We have been promised partition, whereby what we put in will be preserved for the good of our locality, but we are not clear how long into the future that partition will last.

Only three of us across Scotland have so far voted for the single umbrella trust, so we have been asked to propose a trustee because at least three trustees are needed to go on the initial deed. That can be changed thereafter. We will propose a trustee from our locality who is independent of the college.

The Convener: If there are three trustees and two come from other areas, in the future there would be nothing to stop those two trustees deciding that the pressures that were faced in the west or the south of Scotland were more significant, so the money could be used there.

Margaret Munckton: Absolutely—so we are relying on compartmentalisation.

The Convener: That is a leap of faith.

Margaret Munckton: Yes.

Susan Walsh: You have just rehearsed the arguments that have been had in boardrooms around Scotland over the past six months.

The question of how we ensure that the money that is generated by colleges is used to benefit those colleges can be dealt with in the context of the charitable status of the arm's-length foundations. It is a matter of defining the articles and the constitution so carefully that money could not be used for anything other than the benefit of the students of the institution—the region or the college—that set up an arm's-length trust, whether the trust is a Scottish charitable incorporated organisation or otherwise.

As Alan Williamson said, the issue is very much about independence, but it is also about ensuring that the funds that have been generated are used for Scotland's learners.

Alan Williamson: I was just going to repeat what Susan Walsh said. The creation of arm's-length trusts would give colleges a lot more flexibility in how they can generate commercial income, in particular, which could be reinvested in the college.

The Convener: What will the charitable status of colleges be in the future? What are the implications for that?

Susan Walsh: We understand from the funding council that the charitable status of incorporated colleges will be unaffected by the ONS reclassification.

The Convener: Has that been guaranteed by the charity regulator?

Susan Walsh: We have had sight of a letter from the Office of the Scottish Charity Regulator that says that charitable status will be unaffected.

The Convener: Right—there should be no financial implications for colleges with regard to their charitable status.

Susan Walsh: We hope that there will not be.

The Convener: I thought you said that there was a letter that guarantees that.

Susan Walsh: There has, indeed, been such a letter.

The Convener: So why the hesitation?

Susan Walsh: It was not hesitation. One of the things that we learn as college principals is that the political context changes. As of today, we have a guarantee of what we can expect, but that might change in the future. We do not know.

The Convener: I presume that that would require a change in the law or a change in the way in which the charity regulator operates, because that should not, in the first instance, be subjected to political influence.

Susan Walsh: I meant "political" in terms of the political will to change legislation that might have an effect.

The Convener: Okay.

Tavish Scott: Could you describe the financial role that the regional boards for the 13 college regions will play, please?

Susan Walsh: One of the issues is that the regional boards will all be different. I can speak for Glasgow—Henry McLeish will allow me to do that. In Glasgow, the regional strategic body will have three assigned colleges. The funding will go to the regional strategic body and will thereafter be distributed on the basis of evidence related to the regional strategic framework that we are developing in Glasgow. The regional board will be the fundable body.

11:15

Tavish Scott: What will individual colleges do to ensure that they get their fair allocation? Will they simply have to fight hardest at meetings?

Susan Walsh: Absolutely. You used the term "fight", but I would say that it is more like tag team. As the three colleges that now exist in Glasgow are part of what historically was known as the Glasgow colleges strategic partnership, we already had an operating framework for working together. In some ways, the regional strategic body is simply putting in a governance layer that would have lain with the college themselves.

Tavish Scott: In that case, what will the board bring to the party?

Susan Walsh: The board will bring the capacity to speak with one voice for Glasgow. Glasgow—by which I mean not just the city itself but its metropolitan area—makes the highest gross domestic product contribution to Scotland. The board will allow us to engage with key stakeholders with one voice in a way that was not previously possible.

Tavish Scott: I get that—and it seems like a fair point—but are you concerned about the potential for individual colleges to lose out? I presume that there will be some concern at lower levels that you are not all going to get everything you want from the overall allocation that will be given to the regional board for Glasgow.

Susan Walsh: I do not think that anyone ever gets everything they want. The point is that the colleges are better being interdependent than being independent, simply because the regional strategic framework and the college plans that will allow us to meet that framework's aims are being built from the bottom up, starting with an economic skills analysis and discussions with our key stakeholders, our employers, our schools and the universities. We are not working in isolation and then saying, "I want that bit of the cake." That is not the mechanism that we are developing.

Tavish Scott: That is fascinating.

Margaret Munckton mentioned losing a hospitality course at Perth College. Does that mean that in the comparable structure in the north there are already examples of colleges other than Perth College not being able to gain funds for particular specialisms that they want to pursue?

Margaret Munckton: I make it clear that the hospitality course was based on modern apprenticeship funding that flowed through SDS.

The situation is very different in the Highlands and Islands region, because the University of the Highlands and Islands university court is being proposed as the regional strategic body. In other words, the university court will be responsible for the flow of funds to FE as well as to HE throughout the region. There are well established principles and committee structures to ensure the distribution of HE funding, but the fact is that there is no great competition in that respect. Conversely, the funding envelope for FE is not big enough, so the situation will be slightly different when adjustments are made through the regional strategic body.

Concern has been expressed that the top slicing that was mentioned earlier might be applied to the flow of FE funds, but we have received reassurances that that will not happen. However, we believe that, as our FE regional board will be a committee of court, our regional lead will not be appointed through the public appointments process. I understand the anxiety about using that process to appoint the chair of a university committee, but I must point out that the body itself is not a committee of court at this moment in time. The appointment of the regional chair, who will also become a member of the university court, is certainly exercising us at present.

Tavish Scott: Who will make the appointment if it is not going to be made through the public appointments process?

Margaret Munckton: The appointment will be made by the court itself, which is being reformed at the moment.

Tavish Scott: I presume that, given the differences, you would prefer the appointment to go through a similar process to that which is used in Glasgow and other parts of the country.

Margaret Munckton: Such an approach would be a lot more transparent and open in governance terms.

Tavish Scott: On the principle of the system that you are about to be part of in the UHI—I take the point about the size of the cake and so on—how will that work? I presume that you will all get round the table once a year to sort out the allocations for individual further education institutions.

Margaret Munckton: The direction of travel is that the smaller colleges in more rural locations want to offer a wider range of provision. We understand that; we have done that in FE by networked delivery, so we can deliver at a distance. However, we do not feel that that is appropriate for the maturity of the learners—I mean not their age, but their maturity as learners—at FE colleges. If, as a regional board or a committee of court, we want to support more activity being nested in the remote areas, we will need to sacrifice larger class groups in the urban areas. The reality is that a class of 28 at Perth College could be sacrificed for a class of nine in Orkney.

Tavish Scott: You will have such dilemmas.

I will ask about Edinburgh College's situation in terms of the regional board. Is the situation the same as we have heard it is in Glasgow? Is that how you envisage the structure working here in the east?

Alan Williamson: Our regional board is formed. The financial strategy is agreed by the board, so we have a good idea of what we will be planning for and, I hope, what we will achieve in future years through our approach.

Tavish Scott: Okay. I guess that your pitch to the SFC—I assume that this applies to all the witnesses—will be for funds that are based on the assessment that you make in the strategic plan that was mentioned previously.

Alan Williamson: It will be, although the outcome agreements also tie into the approach. The SFC has its guidance from the Government on what we should focus on through the outcome agreement to make the system much more joined up.

Tavish Scott: The flipside of that argument is how much discretion local colleges have to answer local economic needs in respect of skills needs and skills training. Will there still be room to make that argument through the structure that comes with regional boards, and therefore to ensure that that becomes part of the overall strategic plan for your region?

Alan Williamson: We certainly identify needs in the community. That information is fed to the SFC, so it should form part of the outcome agreement.

Tavish Scott: So, in other words, it is not a straitjacket—there is flexibility.

Alan Williamson: There is flexibility.

Tavish Scott: Okay.

Audrey Cumberford: The outcome agreements are aligned to the single outcome agreements in relation to the community planning partnerships, so for local colleges there has to be alignment with their local authority CPP areas as well as with the national outcomes.

Colin Beattie: Paragraph 19 onwards of the Auditor General's recent report on colleges mentions pensions deficits. As has been said, the pensions deficit is £115 million, which is acute and has grown over the years. There seems to be no indication that the deficit will do anything but continue to grow. I understand that that covers only the local government pension scheme and not the teachers, who are in the Scottish teachers superannuation scheme. How do colleges view that deficit? It is a lot of money. I presume that at some point somebody will have to cover it.

Alan Williamson: I can comment on Edinburgh College. Last year, we had a deficit of about £11.5 million and this year we are down to just under £9 million, so there has been a positive movement, mainly because the economy has picked up and the value of our assets has improved over that period.

Valuers make a number of assumptions in valuations. One on which there is a degree of flexibility is the pay assumption. They tend to use the local authority pay assumption, in which incremental scales and regular pay awards are built in, but within the college sector, including at Edinburgh College, we have not had a pay award for two or three years, although this year the award will be about 1 per cent. We can therefore get a more accurate reflection of the situation. However, we are limited to the value of the liabilities; when people leave the scheme, that liability is carried and, of course, new members who join a scheme contribute at a lower level.

Alan Williamson: How does that affect the college sector overall? It depends on the size of the deficit, but the impact is predominantly through the contribution side. If the deficit keeps rising in the future, it is likely that the contributions that the organisations pay will be increased.

Margaret Munckton: The contributions have been increasing. Alan Williamson can help me out on this, but the teachers' scheme is on a different basis and there is no fund as such, so what is received is paid out. In accounting terms, that system has a different status. The issue of the teachers' pension scheme is not being avoided; it is just run differently from the local government scheme.

Colin Beattie: One of the comments that was made by the Attorney General was to the effect that there are a number of different contribution rates even within the same pension scheme. It is not explored in any depth in the Attorney General's report—

Colin Keir: You mean the Auditor General.

Colin Beattie: I am sorry—I meant the Auditor General's report. Perhaps you could give a little more information about how that works.

Alan Williamson: When there were three colleges in Edinburgh, we all paid separate contribution rates, ranging from 17 to 20 per cent. The contribution rates were based on the age and number of staff, and when we were likely to pay the pension benefits.

The Convener: Can I have clarification? Margaret Munckton said earlier that contribution rates are increasing. Does that apply to individual participants, or just to employers?

Margaret Munckton: Contribution rates have also been increasing for individual participants.

The Convener: What scale of increase has there been?

Margaret Munckton: I am not sure, because I am not in the local government scheme.

The Convener: Does the same pertain to the teachers' scheme, or does it apply just to the local authority one?

Margaret Munckton: It is proposed to increase the contributions for the teachers' scheme, but I do not think that that has happened yet. However, the local government scheme contributions have definitely increased.

Alan Williamson: My contributions have probably gone up over the past three years from around 6 per cent to 9 per cent.

The Convener: Okay. I am sorry, Colin.

Colin Beattie: The size of the deficit is obviously a worry. However, you are not alone in that situation, because right across the UK changes in accounting and bond yields and so on have resulted in deficits. For you, what would trigger a decision to put in significant sums?

Margaret Munckton: Pensions crystallise only on retirement. Provided we are an on-going business, we will always have people starting in the pension scheme and people leaving it. It is about having faith in that demographic and that we will always have a timeline of leavers and no absolute hit from mass leavers.

Colin Beattie: You have a £115 million deficit now, but what would happen if it went up to £200 million or £250 million? At what point would you be concerned?

Susan Walsh: The difficulty is that the variation tends to be in response to actuarial valuations of the pension scheme. I am sure that Alan Williamson will be most distressed to hear that I tend to think of accountancy as a kind of black art when it comes to figure changing. Alan alluded to the fact that his college's pension deficit improved by £2 million last year, as did Glasgow Clyde College's, although we did not do anything different. The pensions' value going up and down can contribute to that variability.

Margaret Munckton's comment about crystallisation was very well made, but the other issue is that colleges have to be going concerns. In some ways, that question harks back to issues around the ONS and funding. We cannot tease out one distinct strand, because they are all interrelated. It is our ability to manage the funds that we are given and to generate additional income that allows us to sleep not necessarily particularly well with reference to such a huge pensions deficit, but to sleep, because we understand that our colleges are strong and on-going concerns.

Colin Beattie: The Auditor General's report mentions only two pension schemes. Are they the only two? Are there any closed pension schemes?

Susan Walsh: None that I am aware of.

Margaret Munckton: No.

Audrey Cumberford: No.

Alan Williamson: At present there are only two pension schemes in the college sector, for teachers and for support staff. One is a defined benefit scheme, which is the one that is reported as showing a deficit, and the other is a contribution scheme, which is off balance sheet and is just noted in the narrative of the accounts.

11:30

The Convener: I want to clarify something. You mentioned that retirement was one of the issues. If my memory serves me right, there was a significant expansion of the public sector in the late 1970s and into the early 1980s. Does that mean that there will be a bulge of people who are now approaching retirement? Although some of those people may well already have chosen to take early retirement, is there a significant bulge that would otherwise not be there?

Margaret Munckton: I am not sure about the national demographic in that regard, but I am sure that the answer could be researched.

When anyone over 50 who is in a local government pension scheme—which includes all our support staff and a lot of our management staff—takes severance or early retirement, there will be a significant pension strain on colleges in terms of what they have to pay.

The Convener: Has the impact of the early retirements been quantified?

Margaret Munckton: I am not aware that it has been quantified. It may have been.

The Convener: Surely that should be done. If you say that it is a significant strain, surely you should know how much that strain costs.

Susan Walsh: The impact has not been quantified on a sectoral basis, but individual colleges collect that information. We lost 154 staff last year from the three colleges that formed Glasgow Clyde College, which cost us somewhere in the region of £4.8 million. We then had a further £770,000 in strain costs. That situation will have been repeated elsewhere in the sector.

Bob Doris: I will begin by congratulating the colleges on how they have managed a difficult period of change and transition. It is worth putting on the record that there was a 9 per cent reduction in budgets, which was dealt with by reducing the head count, mainly among teaching staff. That was a political choice, and it is clear that you have all managed it well.

Currently, we are in a period of modest rising budgets, although I also put on record that that is from a much-reduced baseline. I would like to ask some questions on how you are dealing with the current baseline.

We have heard much talk—understandably—about the reduction in head count among those involved in courses. We have also heard that the number of full-time equivalents remains the same; the figure that I have is roughly 119,000 full-time equivalents in relation to courses throughout Scotland.

I am interested to know how you map applications to each of your colleges for those courses. The Auditor General's report recommends that colleges should

"implement the Scottish Government's recommendations to improve the application process to help monitor the demand for college places."

How is progress going in that regard? For example, in Glasgow—I will use the old college names rather than the new ones—if someone applies to North Glasgow College, Stow College and John Wheatley College for very similar courses, would that count as three individual applications even though they are from only one person? That one person may very well get a college place, but the accounting procedure appears to show that two people have been unsuccessful. That is not deliberate, but it gives a false picture of where we are in terms of demand. How are colleges getting on with addressing that key recommendation?

Susan Walsh: Colleges have always recognised that. Indeed, a person may apply not only to three colleges, but for three or four courses at each of those colleges, so the problem is magnified.

That was not of particular concern when we were in a position of growth throughout the 90s and early 2000s. If someone applied and we felt that they had—this term was always used—a reasonable chance of success and we had the student funding to allow it to happen, we ran courses. That is why the college sector grew. That reasonable chance of success criterion is why college education is so important. We now find ourselves with a management information system that does not necessarily meet the needs of the new regime in which we find ourselves operating.

In Glasgow we are looking at a common Glasgow application process. However, I would like to separate applications from admissions. Applications to university are handled through the Universities and Colleges Admissions Service. It has a highly motivated, highly skilled and very literate population of applicants. The people who come to colleges are very different. We have people with literacy problems and personal difficulties; we also have real high fliers and graduates who come back into the college sector because they want vocational education. Therefore, it is not necessarily an IT solution that is needed.

We have to look at how we can suck data out of existing college applications systems through some platform that would sit above the systems. That would allow us to say that 300 people—it is people who are important—have applied for 56 different courses, for example; it would also allow us to interrogate the information properly, which would give your committee and others that information that you are looking for. It would be much more accurate.

Bob Doris: That was quite a lot of detail, which I appreciate, but I want to get a sense of whether work is in progress across the college sector to look at a college application registrar, who could audit the process effectively but in a way that did not dissuade people from vulnerable backgrounds from applying to college in the first place. Is such work on-going?

Audrey Cumberford: I have a particular worry that the debate about what counts as a head count of student numbers and how big our waiting lists are is almost a distraction that could drive us in the direction of coming up with national e-solutions when what we need are local responses.

Should individuals have the flexibility to apply for three or more courses in my college, and to apply to my college and Susan Walsh's college? Absolutely, because that is the nature of those students. In more cases than not, students who apply to my college saying that they want to do three courses do that because they do not know what they want to do. Colleges are different partly because we put resource into the front-line service to help those individuals decide what is the best course for them and, sometimes, what is the best college for them. You need a local—or, in our case now, regional—perspective. If we start to get into the numbers game, I am concerned that we might become driven by national concerns about counting numbers and demand.

I will finish off on my high horse. Renfrewshire is similar to Clydebank and Inverclyde, in that we have very similar demographics and youth unemployment levels. We have approximately 1,500 young people who are not in school, education or work. For me, that is the unmet demand. Forget how many people apply to my college: that is the unmet demand in Renfrewshire. The situation is replicated in Inverclyde and Clydebank.

As a college, working with our partners through the CPPs, our responsibility is to address that problem and not get bogged down in whether we have an IT system that can tell somebody somewhere that a person has applied for one or more courses.

Bob Doris: I did not suggest a solution to how you map out—

Audrey Cumberford: I am sorry; the rant was not at you.

Bob Doris: No. I have to say that I have had enough of scrutinising IT systems at the Public Audit Committee to last me a lifetime, so let us not go there.

I acknowledge the comments that you made, Ms Cumberford. Would you acknowledge that, in terms of regional planning, it is important to get a proper and accurate picture of how many students apply for courses and whether they apply across a range of colleges? I do not think that you mentioned whether you thought that that mapping exercise was important to forward planning. I am not sure how colleges can do forward planning without having that picture.

Margaret Munckton: We look across trends and conversion rates, from applications to offers made to people actually turning up on the day. Actually, the demand that is exerted is often articulated when people physically turn up on the day, so any extrapolation of data will not provide clear information about that. However, we can use trends from previous conversion rates and we also get a lot of information from speaking to the students themselves. I know that we are starting to put a likelihood score against applicants. Often when we talk to applicants, they will say that they have applied to such-and-such colleges and we give some advice. Although all the MIS systems record each application, we can filter the data to say that the likelihood is that a particular student will not turn up. That is about people intervention and it is about people talking to individual applicants.

The Convener: Does Bob Doris have a final question?

Bob Doris: Before coming on to my final question, I stress that the reason that I have asked about mapping of demand for course provision is that, as well as being a key recommendation from the Auditor General, most people would think that better mapping would be a good thing. I am sorry that, due to time constraints, we are not able to continue that discussion with the witnesses.

I do not want to get into the political discussion about full-time equivalents: the Government has said that it has maintained full-time equivalent numbers, whereas the Opposition has said that head count is down. Let us park that argument to one side.

Scotland's colleges are on a secure financial footing because of the tough decisions that they have taken. However, another key recommendation in the Auditor General's report is on preparing for future capacity. If a political decision is taken further to prioritise certain key groups, such as older students, for modern apprenticeships—I must say to Ms Munckton that different parts of Scotland will argue over who should get those 25,000 apprentices, but that is another issue—will forward planning by Scotland's colleges enable them to say how they would go about expanding provision for that unmet need? How would they up capacity if such a decision was taken?

Susan Walsh: That is something that colleges do all the time. During the period from 2002 to 2005, which was probably the most stable financial period that colleges had, we demonstrated that we could rise and fall with demand depending on what was required. Going forward, we absolutely have processes that would allow us to identify areas where growth would be appropriate. We have shown that we can respond to the opportunities provided by new organisations opening up.

For example, the largest hospital complex in Europe is currently being built in Glasgow. For that, the local colleges in the west and in Glasgow have been working hand in glove with the health board to ensure that, when the new institution is fully functional, it will have the employees that it needs in areas such as estates, catering, science lab technicians—we even have a new nursing or paranursing qualification. We have the ability to make change and to respond. At the moment, the difficulty is that we just do not have the funds to allow us to meet all the demands that people make on us.

The Convener: We need to move on, as we are running out of time. I call Ken Macintosh, to be followed by Colin Keir.

Ken Macintosh: On a related subject, it is clear that you are struggling with reduced budgets. You have lost a lot of staff in the past year. Are you looking to lose staff again in the forthcoming year?

Susan Walsh: Yes.

Margaret Munckton: Yes.

Audrey Cumberford: Yes.

Ken Macintosh: Will that be on a similar scale? I think that you lost 1,200 staff across the board in one year. Will the losses be on a similar scale this time or slightly less or slightly more?

Susan Walsh: I can speak only for my college. We expect to lose some staff but on nothing like the scale of the past two or three years.

Audrey Cumberford: The situation for West Scotland College is similar.

Ken Macintosh: As Mary Scanlon pointed out, student head count was reduced by 48,000 in one year. Will head count be reduced further?

Susan Walsh: That is quite a difficult question to answer simply because we are also facing a changing funding methodology. Some key decisions need to be made to allow us to work out what a full-time student will be in the future and what the value will be of the weighted credit in future. Therefore, we cannot answer that at the moment, but the Scottish funding council needs to give answers on key issues quickly, so that we can plan properly.

Ken Macintosh: In effect, you are going to get less money per student.

Susan Walsh: Not necessarily—we do not know. We do not know what will be the value of a weighted credit or how many weighted credits will make up a full-time student. We know what that might be roughly, but "roughly" could mean huge variance in the FE budget, so that does not give us any comfort or capacity to plan in detail.

11:45

Ken Macintosh: I am conscious that SFC witnesses will give evidence in the following panel, so what would you like them to tell you?

Susan Walsh: First, we need absolute clarity on the weighted credit and on how many weighted credits will make up a full-time student. We also need much more clarity on the needs-based element. We are concerned about some of the figures that we have heard on supporting extended learning support students. At present, colleges respond to students as they come forward with special needs, but in future that will probably be limited, although not necessarily capped. We also need to know about deprivation funding, which we understand will probably be of a lesser scale than some other funds.

Audrey Cumberford: A key word for me is "stability". Albeit that, given what we have just gone through, the stability in this year's funding and in what we know about next year's funding is fairly minor, it is welcome. However, margins continue to be extremely tight. For example, in West College Scotland, on a turnover of more than £50 million, we are forecasting a surplus of £50,000. The analogy that I use is that it is a bit like trying to land a 747 on a postage stamp. It does not take much to swing the figure into a negative. The issue that Susan Walsh just mentioned about certainty on funding is key. The funding scenario has the potential to continue to stabilise the situation, or to destabilise it.

Ken Macintosh: To pick up on the point about development education courses for those with additional needs, an awful lot of such courses—I think that it was between a third and a half of them—were lost in the initial round of funding cuts. Are you suggesting that there could be further cuts to that vulnerable sector?

Susan Walsh: The funding that I was referring to was for extended learning support, which is for students who are on mainstream programmes but who have additional needs—for example, they might be dyslexic or dysgraphic. At present, such students go through an assessment process and we put together a package that allows them to remain in college and be successful. That is done individually. Those students simply gather weighted student units of measurement, and we draw down funding to allow that provision to continue. Our understanding is that, from the funding council's perspective, that approach might not be viable in future, and that extended learning support, which has been growing year-on-year, might be not necessarily capped but limited in some way. We have real concerns about that, because as students and their parents and employers become clearer about the kind of help and support that students need to be successful, expectations are greater and therefore there is a greater demand for ELS.

Ken Macintosh: Ms Munckton, do you expect either to increase class sizes or reduce the number of hours that students spend with lecturers and other staff?

Margaret Munckton: At Perth College, we have resisted the removal of learning hours. We have capacity to remove hours, because the current funding system allows us to claim a tariff-weighted SUM and deliver slightly less than that, but we are determined to deliver what is appropriate. That has an impact financially because, under the existing rules, we could deliver less and get the same money. However, as Susan Walsh says, those rules are about to change. The increase in class size is absolutely key to our balancing the books. We now use lecture theatres to deliver theory to 100 students at a time, and they are then split into groups of 20 for practical work.

In the workshop situation, there are all sorts of health and safety considerations about having one lecturer to 16 or 17 students, and there are health and safety limits that we will not go over. However, where we can disaggregate the delivery of theory from practical work, we are doing our level best to increase the average class size. We are not doing that at the expense of quality, because we are keeping an eye on and listening to students' views about the quality of the experience as it is happening.

Ken Macintosh: Is that—

The Convener: This should be your last question.

Ken Macintosh: Okay. Is that also the situation in the other colleges, in relation to the amount of hours that students get with staff and the size of classes?

Susan Walsh: There is definitely a benefit from full-time courses at the moment. It is the extra resource that full-time students attract, which we are going to lose under the new funding methodology, that we use to support students and maintain other facilities and services for them.

It is about increasing class sizes, but only to a point where they are manageable. We are aware that staff have worked incredibly hard. You kindly said that we have managed the difficult situations that we have faced, but it is the staff who have dealt with increases in class sizes.

We have looked at new learning methodologies and the use of IT. As Margaret Munckton said, there is a distinction between practical skills and theoretical knowledge. I think that we would probably all have done the same thing.

Alan Williamson: It is the same in Edinburgh.

Colin Keir: Good morning. As far as I can see from the report, it is a little bit early to tell how painful or difficult the process that you have gone through has been. What has been the most awkward thing in managing the merger of the colleges into regional entities? How flexible will the management structure be in enabling you to respond quickly to local requirements in future years? I am pretty sure that you have partly answered that, but the projections for public expenditure over the next number of years suggest that it is not going to be easy. We all realise that everybody would like more money, but how are you going to manage this difficult situation if the period of austerity carries on for, say, another seven, eight or nine years?

Alan Williamson: For us, the biggest challenges in dealing with the funding cuts were having only a short time in which to restructure and integrate systems, and keeping staff motivated when they were going to be applying for jobs, given that, at the senior and management levels, we moved from three to one—that is one of the benefits of the regionalisation, given that the resource is less. Another challenge has been keeping budgets in a break-even or reasonably positive position throughout that period.

On the positive side of the regionalisation, systems integration helps with the provision of information. Before the merger, the three colleges in Edinburgh were running off three different systems and they had different working practices—even for finance, would you believe? They were at different stages of automation as well. It was hard to pull all of that together. The benefit going forward is that, once that has all bedded in, it should produce some economies and efficiencies as people get on top of things and we implement the new working procedures. Where we have had to top up with temporary staff to help us through the transitional phase, those staff will then move on, and we will come to a lower cost base as a result.

Margaret Munckton: It is also fair to say that the loss of teaching staff included the loss of many managers. Those affected were on teaching terms and conditions, and included a lot of our middle and senior managers. Of the 1,200 teaching staff involved, a high proportion of the losses at Perth College to date have been among the middle and senior management levels.

Willie Coffey: At the weekend, I was delighted to attend the graduation ceremony at Ayrshire College's Kilmarnock campus. The atmosphere and the excitement were incredible. If that is reflected in any way throughout the rest of the college sector, there are exciting times ahead of us.

The Auditor General's report said:

"The overall financial standing of the college sector in 2011-12 continued to be generally sound."

It also mentioned that the colleges are sitting on £214 million-worth of surpluses.

My question is aimed at Margaret Munckton, because she mentioned that she was unable to fund a particular course. A quick look at the report tells me that your college has £5 million-worth of surpluses. That is public money, from the public purse. Are you able to or did you consider using a portion of that money to fund that course? If not, why not?

Margaret Munckton: We certainly fund courses, including loss-leading courses, and all sorts of things because it is the right thing to do, even though it may not make financial sense to do so. I am convinced that we will take the right decision for the region, the communities and our students. However, that £5 million is not sitting in a bank account. If it were, we would be getting 0 per cent return on it and therein lies the truth. We generate quite a bit—as I mentioned, it is about 44 per cent—of non-public funding annually. We will not spend that haphazardly. We get very little through the capital funding route; indeed, we have not had a lot of the capital funding that other colleges have had. We have a building that was built in the 1970s that is full of asbestos; we also have flat roofs. We have an on-going repairs and maintenance plan and an ambitious estates development plan for the benefit of our communities and our students.

We are not able to, nor do we want to, rely on loans, because we would be worse off and restricted with regard to, for example, the covenants that are requested. We were therefore building up the reserves. They certainly do not amount to £5 million. I know that Alan Williamson has detailed information on Edinburgh that will illuminate the situation. The money is not cash to spend; it is an accounting reserve, which is totally different. We have commitments in advance to develop more of our buildings for student residences and to enhance the student experience and for the on-going renewal of plant and equipment, so that our students learn using, for example, the latest computer technology. That investment burden is what those reserves are addressing. The money is not sitting in a bank, waiting for a rainy day. Alan Williamson can give you more of the detail behind that.

Willie Coffey: Yes, please.

Alan Williamson: What the Audit Scotland report said about cash and cash equivalents was probably unhelpful because it gave the impression that the colleges are sitting on lots of cash. Edinburgh College is a good example to cite in that regard. On the cash and cash equivalent basis, it would seem that we are sitting on a £30 million surplus. However, we had an outstanding bank loan of about £7 million to pay off as a result of the merger and the banking covenants that we had in place. We also had proposals for a £5 million development at the Sighthill campus. Taken together, that is £12 million already, and it leaves £18 million. Of current liabilities, we have to pay off £12 million to the short-term creditors with a year. That leaves us with £6 million of net current assets, which is a truer reflection of the position. However, some of that money is restricted funds, which we can use only on capital purchases. If we take a long-term perspective and look at our long-term liabilities, we have our bank loan and the VAT that we must pay, which totals £15 million. On top of that, we have provisions and other stuff like that. That is why I believe that the Audit Scotland report missed the other side of the equation. The cash and cash equivalents were identified, but it would have been better to read the liabilities side along with that.

12:00

Willie Coffey: Those were very interesting answers.

The Audit Scotland report says that your college has £57 million of reserves.

Alan Williamson: That is actually the income and expenditure carry-forward. Surpluses come through the income and expenditure account every year.

Willie Coffey: We can talk about that in the next session.

You have described a range of obligations and commitments that are already earmarked, but it seems that, in some cases, choices can be made about how to deploy that money. I was interested to learn that the money is not in any bank accounts and that it is not real money. I will have to pursue that on another occasion.

We know that plans are developing on how to treat college surpluses and how to deal with them when you become public bodies next year. Discussion is under way on that. What are your thoughts on how that money can best be deployed?

Margaret Munckton: It would be remiss of us not to make the point that, because of the different accounting principles that will apply to the sector under the ONS reclassification, the sector will record a massive deficit across Scotland in accounting terms. Colleges will need to show the transfer of cash to arm's-length foundations as money spent. In future, under ONS restrictions, colleges will show deficits in their accounts, so it will look as though the college sector is insolvent.

Willie Coffey: From £214 million-worth of surpluses? I do not understand that, but perhaps we can come back to the issue.

Susan Walsh: Perhaps I could speak on the issue of the surplus. My college had a financial strategy to generate 2 per cent of our turnover—around £500,000 per year—as surplus that we earmarked for specific projects.

Our financial strategy will now change, because the college does not have the capacity to generate that level of surplus. That is not because we are going to reduce in any way any of the commercial activities that we do outwith our public funding; it is just that we will have to use the money in year to ensure that we maintain the level of service and quality for our students. The methods that we used to generate a surplus will remain, but the level of the surplus will diminish. I am sure that that will be the case across the sector.

I was interested in what was said about what will happen when we become public bodies. We absolutely respect the Parliament's decision with regard to the ONS reclassification; we understand that it has made that decision. However, it further confuses an already complex position. We tend to be of the public sector but not in the public sector. At the moment, our academic and financial years are the same as the universities', but that will have to change with our reclassification as public sector bodies. On the other hand, we are not party to public pay policy—that does not apply to colleges.

We will have to be public bodies as far as accounting practices are concerned but, in other ways, we will not be subject to the same expectations. We are expected to be highly competitive—not with one another but with external providers—to generate income. We are a chimera; we embody bits of everything. That is sometimes difficult, especially for staff, who might think that it is great that we will be back in the public sector, as that will give us a level of stability because the Government will have to look after us. In fact, that is not the case. We understand why the ONS is with us, but the question whether we are public sector will continue to cause complications for college leaders and boards.

The Convener: I had some specific questions about West and the relationship to students in Clydebank, Greenock and Paisley, but we will just write to you about that. I can raise that with the committee.

There was one thing that I wanted to ask in public. It goes back to what Alan Williamson said about the cash and cash equivalents. According to the Scottish funding council, good practice suggests that there should be a minimum of 60 days' cash. In the past, Reid Kerr College had less than one day's cash, which is quite a significant departure from the good-practice guidelines. What are the implications of that?

Audrey Cumberford: In 1999-2000, Reid Kerr College was going through severe difficulties and had a significant deficit and a very poor estate. The decision that was taken by the board and senior executive at the time was that it was not appropriate to stockpile cash reserves and that we would reinvest any moneys that we generated in the estates and back into the college for the benefit of the community. Over a 10-year period, £21 million has been spent on that campus, of which only £6 million has been supported by the Scottish funding council. The college generated income and used bank loans to pay for improvements for the benefit of students and staff. It had a strategy of working on an overdraft for that period and has successfully done that for 12 years. I absolutely believe that, at that point, given the funding environment that we were in, that reinvestment was appropriate.

In the current funding environment and context, that course of action would not be appropriate for West College Scotland. We have a target this year of 35 days' cash, which will go up to 37 days' cash next year, although it becomes irrelevant after

March 2014 in the sense that we will hold a level of working capital amounting to about £3 million.

The Convener: Given that you are aiming for 35 or 37 days' cash, should the Scottish funding council guidelines be reviewed?

Alan Williamson: It depends on the size of the college and its turn-in liabilities as it goes through the year. Each college would have to consider its situation. It also depends on how quickly a college is turning its debtors into cash, which influences how much cash it wants to hold, because it is really to do with short-term working capital. I have always thought that 30 to 60 days' cash at least gives us headroom to be able to deal with liabilities should we have a problem bringing in the income.

The Convener: Thank you for your contributions. We may have further questions, in which case we can write to you. Thank you very much for your time.

12:08

Meeting suspended.

12:14

On resuming—

The Convener: I welcome our next panel, which is from the Scottish Further and Higher Education Funding Council. Laurence Howells is the interim chief executive; Martin Fairbairn is senior director, institutions and corporate services; and John Kemp is director, colleges and post-92 universities.

I think that Mr Howells wants to make an opening statement.

Laurence Howells (Scottish Further and Higher Education Funding Council): Yes. Thank you for inviting us to give evidence on the Auditor General's recent report. We worked closely with Audit Scotland as it developed the report, which contains a range of useful points.

I am delighted that the report records that the overall financial standing of the colleges remains good, and I welcome its recommendations for us as an organisation and its encouragement particularly to continue to develop outcome agreements in the process with colleges.

It is worth saying that I am here in my capacity as the Scottish funding council's accountable officer. As such, I am responsible for delivering the Government's policy objectives and the deployment of resources to that end, and for the planning and risk management that are necessary to do so efficiently and effectively.

It is also worth recording some of the progress that the sector has made. I welcome the comments that were made earlier about the good progress that the colleges have made on regionalisation. Twenty-seven colleges have decided to merge into 10 colleges of scale and influence across Scotland. Working with the new regional college structures, student activity remains constant—indeed, it has slightly increased between 2012-13 and 2013-14.

We are about to start to negotiate a third round of outcome agreements with the colleges, and we see with the sector that those outcome agreements will enable us to further improve that system. We have started the process of allocating our funding to reflect need more accurately.

Reform is not yet complete, of course. We need to maintain the momentum on the college mergers and ensure that they deliver the benefits that they are intended to deliver to learners, communities and employers. We will work closely with colleges to do so.

As I said, outcome agreements are a key method for the future to create transparency in relation to public funds: what they are used for, what is delivered by them and the contribution that the college sector makes to Scotland. As I said, we are just starting the third round of outcome agreements—we have had only two rounds—so there is an opportunity for us all to up our game in respect of them.

We will continue to support the enhancement of quality in the sector and will work with it, the College Development Network and Education Scotland.

Finally, we look forward to playing our part in implementing the new regional structure that was established by the Post-16 Education (Scotland) Act 2013, and particularly the regional and college boards. There will be a particular focus on Glasgow, Lanarkshire and UHI.

The Convener: Thank you.

I do not know whether you were in the public gallery towards the end of the previous evidence session when we had a discussion on cash and cash equivalents and the Scottish funding council guideline of 60 days. The Audit Scotland report shows that, in 2011-12, only six colleges met that 60-day guideline. What is the point in having that guideline if colleges simply ignore it? How do you monitor whether they meet it? What do you do if they do not meet it?

Laurence Howells: We were here during that discussion. I will pass over to my colleague Martin Fairbairn to answer those questions.

Martin Fairbairn (Scottish Further and Higher Education Funding Council): The Audit Scotland description is broadly correct. We have that guidance, but I should clarify that it is primarily internal guidance for us in the funding council when we are reviewing the financial situation of each individual college.

Essentially, we use the guidance as a gateway to say, for starters, what the overall cash and cash equivalent situation looks like. If the figure is round about the territory we expect, we swiftly move on. If it is below that, we either look at the accounts in more detail or discuss with the college what the financial situation is and how it is managing its cash flow on a day-to-day basis.

We were in the public gallery when Audrey Cumberford described the situation at Reid Kerr College. Over the years, we have had very regular conversations with Audrey and her predecessors about how they have worked on a day-to-day basis, as that is a more challenging thing to do when there is less back-up. I think that Audrey would admit that.

Even if the guidance is an internal rule of thumb, will we need to change it? Yes, we will, partly because the reclassification of colleges changes the nature of our month-to-month interactions. Colleges will project to us more what cash they require for the next month, and we will need to manage that across the sector so that they are able to pay their bills on a month-to-month basis and will therefore be able to operate with less of a buffer on a day-to-day or month-to-month basis.

The Convener: Do you have any concerns that, if colleges have to operate on a month-to-month basis with less of a buffer and if they have little in the way of reserves to fall back on, that could cause problems in future?

Martin Fairbairn: We, with colleges, will need to strike the right balance between ensuring that colleges have enough cash or working capital to operate on what might be best described as a week-to-week basis, and ensuring that we have slick processes in the background so that, if there is sudden change in a college's cash requirement in week 3 of a four-week month, we can respond quickly to deal with it.

That is one of the changes that flow from reclassification. Colleges will become more like non-departmental public bodies that draw down their cash as they need it. However, there is a balance to be struck, because we do not want colleges to do that every day of the week.

The Convener: I want to explore that issue. Does that mean that the Scottish funding council will be more actively involved in overseeing the management of colleges in a way that it has not been in the past? Does it mean that the SFC will need to expand its management structures to be able to do that adequately?

Martin Fairbairn: In terms of the cash management that I described, yes, more detail will be required. At the moment, we decide on the total amount of grant to allocate to a college or university over a year, and then we simply set out in advance the profile of payments that we will make for that full year. We do not change that unless there are very exceptional circumstances.

From April onwards, essentially the same approach will be taken and we will say "There's the total amount for the year," but on a month-to-month basis we will ask each college what its projected cash requirement is for the month to come and, as long as that is reasonable, that is the cash that we will pay the college on that month-to-month basis.

The process will therefore become a bit more involved, and we will have to adjust our own internal resources and staffing in order to cope with it. However, it will not be a huge step from where we currently are on the cash-flow management. It will therefore not have a huge impact, and we feel that we will be able to cope with it internally.

I think that you asked for something a wee bit more general about the management of colleges. Is that correct?

The Convener: Not necessarily. My query is about how colleges will cope if they do not have reserves to fall back on. You used the word "buffer", so my question is about what the implications would be if the buffer was not there.

Martin Fairbairn: Essentially, we have a similar situation at the moment, except that we are sitting in a different part of the spectrum. We have a fixed prediction of how much we are going to pay each college each month, which is pretty much what we stick to. Colleges have their own cash buffers or reserves—or whatever you want to call them.

What we are doing is moving a bit more along the spectrum towards the position where the colleges have less cash but we have more interaction with them to be more precise about the amount of cash that they need each month. We will still have the existing balance because each college will still have a working capital or cash reserve to manage day-to-day requirements, but there will also be a closer relationship with us, which will help if the prediction changes within the month.

The Convener: Okay. I have a further question about your increasing involvement. There were criticisms in the past that senior managers at some colleges were given enhanced pension and redundancy packages, partly in order to slim down for the changes that were to be made. Concerns were expressed that there was not a great deal of clear accountability and that, arguably, senior managers were looking after themselves, ensuring that salaries were put up ahead of retirement and that enhancements were put in place. Will you have an increased role in determining what financial packages are made available to senior staff who take early retirement or redundancy?

Laurence Howells: We have issued guidance to the sector about severance packages, and the college boards are required to follow that guidance. The actual decisions about individual payments to senior managers are, of course, a matter for the board and not for us. The guidance sets out the governance process that should be followed by the colleges and the matters that they should take into account. We expect them to follow the guidance, which will be the same in the new structure as it is at present.

The Convener: Would it be possible for you to send the committee a copy of that guidance?

Laurence Howells: It would.

The Convener: Thank you. You say that you will have no say over the salaries. As we heard, colleges are now being treated almost like Government departments, and there are governance structures and Government guidelines. Are you suggesting that, despite that, colleges will still be free to set their own salaries for senior managers?

Martin Fairbairn: In Scotland—throughout the UK, in fact—there is no one single categorisation of a public body. That is perhaps unfortunate, but it is a fact. As one of the witnesses on the previous panel said, colleges will—and in fact do at present—exist in a mixed economy with regard to public body status.

The ONS classification at its simplest involves literally moving colleges from one table of reports to a different table. However, Government across the UK has, for a long time, used the classification that the ONS uses to determine other things, such as which financial rules apply to the management of different bodies' finances.

The clearest and most obvious impact on incorporated colleges is that they will have to change their financial year. Committee members may well have seen that there is further information in the Scottish Government's draft budget to show projected cost expenditure and so on. Those sorts of technical changes are happening.

There is an impact on how colleges manage their finances from year to year, as we have just discussed. There is also a range of potential—and they are just potential—other implications for colleges, most of which flow from the "Scottish Public Finance Manual". They range from reporting arrangements for gifts and losses to how colleges manage their pay and so on.

The Scottish ministers have said that they will not apply the Scottish public sector pay policy to colleges as a result of the reclassification. A range of other matters in the "Scottish Public Finance Manual" are under discussion with regard to whether it makes sense to apply them to incorporated colleges.

It is not simply the case that colleges are reclassified and then, bang, a whole set of standard stuff applies; everything is worked through on a case-by-case basis.

The Convener: You will be aware that, in recent years, concern has been expressed about the salaries of principals and senior managers in our universities. They operate almost as a cartel, in that the wages of one will increase as the wages of others in other institutions do so. Very few of them—in fact, none of them, I believe—are now earning less than £200,000 a year, and in some cases they are earning in excess of £250,000.

In recent years, the salaries of college principals have also increased significantly. Will the Scottish Government, through ministers, or the Scottish funding council have any leverage or influence if the boards of colleges decide to increase the salaries and other remuneration payments and the retirement packages for senior managers and principals? Is there anything that you can do if college boards decide just to go for it?

Martin Fairbairn: There is a range of issues in that question; I will deal with the last bit, on severances and so on, first.

To add to what Lawrence Howell said, we have our guidance, which we will share with you, and that guidance includes procedures whereby the arrangements have to be reviewed by the colleges' auditors. If the arrangements made by a college—or a university, as the same rules apply to each—involve stepping beyond that, the auditors must report that to us.

Over the piece, given the public interest in that area, we will take a heightened interest within the existing framework of rules over the next two to three years. Ultimately, however, colleges are autonomous bodies and the ONS reclassification does not change that. Therefore, decisions on such matters are for the boards of management of the individual colleges.

The Convener: Auditors have been singularly ineffective in constraining the pay and conditions of those at the top of universities and colleges. That does not suggest to me that any change will occur in the future, unless the Scottish funding council decides to operate more aggressively. I look forward to seeing what comes out of your deliberations.

We will now have questions from Mary Scanlon.

12:30

Mary Scanlon: My first question is very brief: do you still expect the merger programme and other reforms to generate £50 million of savings every year from 2015-16?

Laurence Howells: Yes, we do. The evidence is that, as a result of the reform process, colleges have delivered an increase of about 7 per cent in the number of students while receiving about 4.5 per cent less in funding since 2012-13. If we combine those elements, the real-terms efficiency gain is calculated at about £49 million.

The situation is slightly different from what we originally expected. As you know, earlier this year, the Government put additional money into the college sector. That has allowed the number of students to grow since 2012-13.

It is important to see that the position results from the reforms that the colleges have undertaken. The colleges have restructured and their number is smaller—they are moving from 27 down to 10, as I said.

Mary Scanlon: I ask my second question as a member for the Highlands and Islands. The UHI has a different financial status from other colleges. I am concerned that the £15 million-plus that is used to run the UHI's administrative office, with more than 200 staff, is top-sliced—that is often said—from the funding before that gets to colleges. That is different from the position for every other college. Student numbers can also be lower in remote and rural areas, so the cost is higher. Is the funding council concerned that, in time, colleges across the UHI network might be given less per student for teaching?

Laurence Howells: We expect the maximum amount of our funding to support learners and their studies—that is absolutely right. We would be concerned if money was being inappropriately top-sliced, to use that term. However, it is important to remember that some of the money that is held centrally supports library and IT infrastructure, the development of the whole network and so on.

As part of our discussions with all institutions and all the regional boards, we will ask them to demonstrate how the maximum delivery is obtained for the money that we provide. One of the key functions of the FE regional board for the UHI will be to bring all that together and ensure that the money is used in that way.

Mary Scanlon: My final question is on the ONS. I am not sure whether you were in the public gallery earlier for the comprehensive discussion about the ONS reclassification, in which the three college principals raised a variety of concerns—I am sure that none will be new to you.

In the report, the Auditor General says that the SFC

"is looking at ways to minimise the impact of government budgeting rules on the college sector".

We also heard about arm's-length trusts being set up. Given when the report was written and the fact that the ONS decision will be implemented on 1 April 2014, will you update us on where you are with the arm's-length trusts?

Martin Fairbairn: The Scottish funding council has set out on our website and in the public domain a significant amount of guidance and templates for articles of association and so on—"trust deed" is not the correct technical term—for the arm's-length foundations.

We in the Scottish funding council are establishing what we are referring to as an umbrella foundation, which colleges will have the option of participating in if they so choose. Essentially, the material that we have published on our website describes how we are setting up the umbrella foundation. We are currently looking for trustees to serve on that foundation, and I understand that they should be identified within the next couple of weeks. We are working on that with the colleges that have expressed an interest in being part of the umbrella foundation.

The vast majority of colleges have indicated that they wish to establish their own arm's-length foundations. That is for a variety of reasons, which I can go into if that is of interest to the committee. Those colleges are using the templates and the guidance that we have made available on our website to establish their own arm's-length foundation. When I had a meeting yesterday with Michael Yuille, who is one of the regional leads working on this area, he described to me how colleges across the piece are making good progress on establishing their own arm's-length foundations where that is their choice.

At the moment, I am reasonably confident that all those arrangements will be in place in time for 1 April. However, if any college hits a difficulty, it can fall back on the umbrella foundation that we are establishing, which can be used where necessary.

Mary Scanlon: The acting principal of Perth College, if I am quoting her correctly, said that only three colleges have voted to be part of the umbrella foundation. However, I appreciate that the issue is a moving target.

Why is the reclassification appropriate for colleges in Scotland? I understand that, in England, the Government introduced legislation to ensure that colleges could continue as they were instead of becoming basically Government departments.

Secondly, we heard from the principals that, on average, around 30 per cent of college funding does not come from the Scottish funding council. As the convener asked earlier, if 30 to 35 per cent of college funding is to be held by arm's-length trusts, how does that make the colleges more accountable to this Parliament?

As accountable officer, Mr Howells, can you say whether the change will lead to colleges being less accountable to the taxpayer? I am not sure what relationship we as the Scottish Parliament's Public Audit Committee or you as the Scottish funding council will have with these arm's-length organisations, which will be totally independent but responsible for 30-odd per cent of college funding. To me, it seems as though colleges will be 30 per cent less accountable.

Laurence Howells: First, that 30 per cent of a college's funding will not necessarily go into the trust, as most of that funding will be earned and spent within the same year. Only the balance would be put into the trust. Secondly, the trusts will be set up so that their purposes are aligned with the purposes of the college sector, so the rules on which they will operate will support that. Finally, when the money is spent within the colleges, it will be part of their normal processes and their normal accounting.

I can pass over to Martin Fairbairn, who may be able to give a little more detail.

Mary Scanlon: The lady from Perth College, I think, said that 21 per cent of her college's income comes from other sources. Obviously, we hope that 100 per cent of the money in the trusts will be spent on training and education. As accountable officer, Mr Howells, you will really have no responsibility or remit over that money. It will have nothing to do with you unless it comes within the college budget. Is that correct?

Laurence Howells: The trusts will of course be independent, but they will be allowed to be set up only if their articles conform to a standard. At the end of the day, that means that, when the money is spent, it will be spent within the college region and by the region.

Mary Scanlon: You did not answer my question. Am I right or wrong in saying that you will have no responsibility for the money while it is held within that arm's-length trust?

Laurence Howells: That is right.

The Convener: Does anyone else want to follow up on the issue of the trusts before we go on to other issues?

Martin Fairbairn: Convener, may I clarify a matter of fact? I understand Mrs Scanlon's point about the arithmetic and the 20 to 30 per cent of college income that comes from other sources, but that is not necessarily what will be lodged with an arm's-length foundation. If a college spends the whole of that income during the year, it will never go near an arm's-length foundation.

The Convener: It came out in the earlier evidence session that you would have no influence or control over the trusts because they are independent, but neither would the colleges. Who, then, has influence and control, and to whom are the trusts accountable?

Martin Fairbairn: I was not making a change to that analysis; I was simply referring to the numbers analysis. Laurence Howells's earlier answer is correct—indeed, it is necessary for the establishment of the arm's-length foundations that they sit beyond public sector accounting.

The Convener: To whom are they accountable?

Martin Fairbairn: Trusts are accountable to their trust deeds—they must stick to those.

The Convener: They are not responsible to the colleges or to you—they are responsible to themselves.

Martin Fairbairn: That is the legal position. We will regularly look for information from colleges and, ultimately, from arm's-length foundations. You are right, though, that there is that bit of clear blue water, which is legally necessary.

The Convener: At the moment, we do not know how much money will go to the trusts. It might be a tiny percentage of the 25 to 30 per cent or it could be a substantial chunk. Any college that wants to ensure that money does not go back to the Scottish Government or central sources could transfer money to the trust and, once it is transferred to the trust, no one has any say over it other than the trustees, who are accountable only to themselves. How is that transparent?

Martin Fairbairn: We will seek transparency in the reporting up the line from the individual foundations to the colleges and to us, so that we understand the flow of moneys and their use. I am not taking anything away from the accountability point, convener.

The Convener: However, once the trusts are established and the money is there, the trusts will be able to do what they want with it—you and the colleges will have no say over that.

Laurence Howells: They will be able to do what they want with it only within the terms of their trust deeds.

The Convener: Yes, but if they interpret those trust deeds imaginatively, that is up to them; it is not up to you or the colleges. There is a leap of faith that we will see what we expect to see. However, once the money is in that bank account, the Scottish Government will have no say or control over it, and you, Parliament and the colleges will have no influence—is that correct?

Martin Fairbairn: In a legal sense, that is absolutely correct.

The Convener: Not just in a legal sense, but in any sense the money will have gone and it will be up to the trustees to decide what to do with it.

James Dornan: Will it not depend on how the articles of association or whatever are written? There will be clear strictures on what the trust is allowed to do with the money. Will there be safeguards in place to ensure that the imaginative thinking that the convener is talking about cannot happen?

Laurence Howells: That is correct. We are setting up the umbrella trust as a model for all the other individual trusts that may be set up.

James Dornan: Would you advise the use of a model similar to yours if not exactly the same?

Martin Fairbairn: That is exactly what we are doing. We are looking to get copies of the individual foundation trust deeds to see the extent to which they vary from the standard template. If they vary significantly, we will discuss with the individual regions the reasons behind that.

James Dornan: You have no control over that money while it is in the trusts. However, when the money is out of the trusts and back in the colleges, will you then take control of how it is spent?

Martin Fairbairn: Yes.

Laurence Howells: We will do so in just the same way as with any other money that is spent by the colleges.

James Dornan: The arm's-length foundation is not new. I am from Glasgow, where we have a number of arm's-length set-ups for major organisations. I am sure that we will work our way round it to ensure that it works fairly.

12:45

Colin Beattie: I have a fairly basic question about something that I have not quite got my head round. What process do you follow to determine how much funding each college gets?

Laurence Howells: I will paint the picture in the regional environment, which is where we are heading. In estimating the funding need for a region, we will principally use demographic factors. Our method will be to estimate the amount of funding that is required for the region on the basis of the number of students and the amount or price per student, which will give us a benchmark for the amount of funding that the region should receive. We will then have a discussion with the region about its needs, the situation that it is in and any special factors that we need to take account of. In our negotiations with the institution on an outcome agreement, we will seek a match between the amount of funding that we will provide and what the institution will deliver for that money.

We are in transition from our existing system, in which the funding for regions is based on the recent past with adjustments that have been made, and it is key that we manage the transition effectively. The recent letter of guidance from the cabinet secretary gave us some rules or advice about how we should manage the transition. One of the key messages in that guidance was that, during this period of change and transition for the colleges, we need to take account of the stability of the sector.

If I may take advantage of the opportunity, that leads me to the comment by the principal of Glasgow Clyde College that she needs further information about some changes that we are making to our funding method. We are providing that information as part of the process that we are undertaking. We do not intend to introduce a new approach to our funding without discussion and proper transitional arrangements to take people from where they are to where they need to be in the future.

Colin Beattie: Does your process include getting bids for funding from individual colleges?

Laurence Howells: Not for the core funding for teaching, but it would be a different matter for special funding for an initiative or a building. However, as we move into the new world, we want to hear from colleges so that they and the special circumstances of their region have a chance to influence how their funding will change over time. We want to move from the rigidly formulaic position of the past, whereby a number was calculated and that was what people got, to a system in which there is opportunity for local dialogue to influence specific issues such as the best way of serving the needs of the populations of two adjacent regions, especially when people want to travel between the regions.

Colin Beattie: It sounds to be very much driven from the top down.

Laurence Howells: The core on which we wish to found our funding is the needs of the population. We will assess those needs using demographic factors and in dialogue with the college regions, which will know their local areas better than we do, and we will try to balance that across the country.

John Kemp (Scottish Further and Higher Education Funding Council): Our intention is that our funding will be driven by demographic and economic evidence as well as negotiation with the college or the region as we develop the outcome agreement. Our intention is that it is driven not from the top down, but by evidence.

Colin Beattie: To be honest, I think that a college would be a bit uncertain about how all that would work. I am not clear about the input of the colleges. Will you protect their core funding but have a bit of bidding and justification outside that to get the money?

Laurence Howells: The guidance letter to us from the cabinet secretary says that there will be a guarantee that no region will lose more than 1 per cent in any one year, which is a kind of tramline. However, we will start from the basis of asking, "What is your current funding? What does demographic change suggest that your region might need to grow to or change to over a period? What information have you got in your college that would give us a special indication that you need some change to your funding?"

Colleges are going through a huge amount of change, so we need to establish a longer-term process whereby if their funding changes, it changes over time and most effectively reflects need.

In the past, our method was extremely top down—there was a calculation on a spreadsheet that was just handed to colleges. We are introducing a new element to enable a proper dialogue to get the best outcome for the students, employers and communities in the regions.

Colin Beattie: The Auditor General has highlighted a pension deficit of £115 million, which might go up or down. How do you monitor that? Do you have any concerns about it, and how do you see it being handled in the future?

Martin Fairbairn: We monitor it through a process that we have had for some years whereby we monitor colleges' accounts and financial projections. We are building that into our outcome agreement process so that we understand how the colleges will meet their array of obligations, including their pension contribution obligations, whether in the local government scheme or in the Scottish teachers' superannuation scheme. Our short to medium-term focus is on how the colleges will meet their actual cash obligations, which means paying their employer contributions into pension schemes. That is part of their financial forecasting and part of our overview of the robustness of their financial forecasting.

For the longer term, pension deficits in the college sector and more widely across the public sector are a challenge because of the growing strain resulting from an ageing population and the economic turbulence over the past few years. To be honest, getting a handle on that begins to go beyond our remit. All that we can do is focus on the short to medium term—the three, four or five-year horizon—to ensure that we have an understanding of how colleges will meet their employer contributions in that period.

Colin Beattie: Is there a trigger point at which you would have a real concern over the size of the deficit?

Martin Fairbairn: I do not think that the concept of a trigger point is so much to do with the size of the deficit. The challenge is the rate of employer contribution, which is now much higher than it was 10, 15 or 20 years ago. For example, at one stage the employer contribution to the local government scheme in Lothian was 0 per cent. Those days are long past and we are now at about the 20 per cent mark, with a possible move to higher rates as a result of future actuarial valuations. Might it hit 30 per cent? Some schemes that are kicking around outside the public sector are into that sort of territory. That would be very challenging for any public sector organisation if other moves are not made in the public finances.

Ken Macintosh: I want to pick up on the points that the college principals made about the methodology that is used to calculate student funding. The Auditor General suggested in her report that she expects the average level of funding per student to fall, but the principals were not sure whether that was the case. Do you think that it will fall?

Laurence Howells: Sorry, but I did not hear that.

Ken Macintosh: The Auditor General suggested that the average level of funding per student will fall. In paragraph 41, on page 15 of her report, she states:

> "However, public sector spending reductions mean that the level of SFC grant support per student is likely to be reduced."

Is that the case?

Martin Fairbairn: Yes—per FTE student.

Laurence Howells: Per FTE, that is correct. That would be the sector average figure, but I think that the principals were also referring to an uncertainty about how we will allocate funding between regions. That is part of the dialogue that we will continue to have with the sector in the coming period to ensure that colleges move smoothly from the old system to the new one.

Ken Macintosh: Just to confirm that, you are saying that the average amount of money per student will be reduced under the new system.

Laurence Howells: Yes—in real terms.

Martin Fairbairn: In real terms—yes.

Ken Macintosh: There was a specific worry about support in the system for students with additional needs. Development courses have already been reduced dramatically as a result of the spending cuts, but the principals also talked about ELS funding, for which there is a specific formula. Can you offer reassurance that the new system will not affect accessibility for students with additional needs?

Laurence Howells: I see no reason why it should. This is another transitional issue: colleges will need to adapt to and reflect on any system that we implement, but we intend to implement it in a paced way so that adaptation is not an issue for them.

It was implied earlier that our funding for ELS currently did not have a limit. That is not the case at the moment, nor will it be in the future. It is all part of the existing colleges budget. Colleges have to balance priorities within that and that will not change in the future.

Ken Macintosh: Yes, but clearly principals are concerned that the changes will have a disproportionate effect on those with additional needs. Will that be the case?

Laurence Howells: I see no reason for that to be the case. What we are hearing today is part of the transition to what might be our new method of funding, which we have not fully determined and which we are working through with the colleges. We are absolutely committed to that not being the case and to the fact that changes to our funding method will not impact disproportionately on people with disabilities or additional education needs.

Ken Macintosh: You said something that surprised me about colleges having additional funding. The Auditor General suggested that between 2011-12 and 2014-15—the three year spending review—the Scottish Government's reductions in spending on colleges will amount to 24.1 per cent in real terms; that is almost a quarter. There was a slight additional revenue grant of £17 million in the budget this year, but even so: a 24 per cent cut in three years. What is the real-terms figure? Is it a reduction? I assume that it is. You talk about an increase, but I imagine that it is a reduction.

Laurence Howells: There is a real-terms reduction in colleges' overall funding, as you said—that is correct.

Ken Macintosh: Do you know how much it will be?

Martin Fairbairn: It depends where you are starting from and finishing.

Ken Macintosh: I am talking about the spending review period from 2011-12 to 2014-15.

The Convener: The Auditor General's figures said that in 2011-12 there was a 9 per cent reduction and then from 2012 to 2014-15 there was a further reduction of 11 per cent.

Laurence Howells: We agree with the Auditor General's figures.

Ken Macintosh: We heard some discussion earlier of the impact of those reductions. The principals suggested that already there has been reduced access in terms of opening hours and there have been a lot of job losses, with more to come. They were not able to answer on student head count. Do you expect student head count to fall?

Laurence Howells: Student head count has fallen over the period. If your question is whether I expect student head count to fall again next year, I do not see any reason for it to fall. It is a difficult thing to predict.

The target that we set for colleges is a student activity target, which is a measure of the volume of activity that takes place. That is the key measure that we ask colleges to account to us. We do not specifically measure or manage college head counts.

In the recent past there has been a head count reduction, which is substantially due to guidance to colleges about getting rid of short courses or very part-time courses, which generate a lot of head count but a relatively small amount of student activity, and the shift towards prioritising full-time provision for young people. Those shifts are part of the policy that the Government set out and part of a move towards a sector that is more attuned to delivering outcomes for students, for the economy and for society.

Some of that shift over a significant period has been about changes to how colleges provide courses that you might typically describe as being at the leisure end of the spectrum and a move towards more substantial courses. I do not see any reason why that should change further; certainly, we do not intend to issue any guidance or advice to colleges that would change that.

Ken Macintosh: The evidence that we heard from the principals suggests that there has already been a number of job losses. We hope that the head count will not fall further, but class sizes will increase and in some cases the hours that staff spend in front of those classes will decrease.

Development education, which has already suffered, may or may not suffer more, depending on other changes. Are you concerned that that will affect the quality of further education?

13:00

Laurence Howells: We monitor the quality of education through two routes, one of which is the activities of Education Scotland, which acts on our behalf to review colleges, their provision and how they organise their quality arrangements. We are not seeing any particularly worrying signs from that route.

We also manage the quality of education through our outcome agreements, in which regions are asked to articulate their targets for improving or maintaining retention. I am delighted that colleges have been able to commit to improving retention rates next year. We expect that to continue and we will ask the larger regional colleges to keep a relentless strategic focus on improving their service to their students and their communities. Through the vehicle of outcome agreements, we should be able to demonstrate that much more effectively than we have ever done in the past .

Ken Macintosh: I have a final question. You suggested that you had produced guidance about the use of severance payments. I made a freedom of information request about colleges' severance payments. The figures that came back were that severance payments rose from £1.8 million in 2007-08 to £3.8 million in 2008-09, £4.5 million in 2009-10 and £18.6 million in 2010-11, before they reduced slightly to £16.3 million in 2011-12 and £10.4 million in 2012-13. The figures show that there has been, at best, a substantial increase. Have all the colleges followed your guidance? Are you concerned that your guidance has not been followed?

John Kemp: We have had no indication that they have not followed the guidance. Some of the figures that you cite are from the period when the mergers were happening, so we would have been funding at least some of those severance payments. We have made it clear that when we fund a severance, it has to have a one-year payback, so that the scheme that a college runs overall has to be one whereby, if it spends £2 million, the staff bill must reduce by £2 million per year. By and large, the colleges have stuck to that, because we will fund no more. Only on very few occasions have colleges used their reserves to fund payments that are more generous than that.

Taking into account the total cost and the number of people who were going in the period before the mergers, the Auditor General's report shows that, compared with other public sector severance packages, the average cost per staff member going is at the mid to lower end.

Ken Macintosh: In the past three years alone, more than £40 million has been spent on severance payments. Something like 2,500 people have been laid off, although clearly a lot more have been taken on. Is that good value?

John Kemp: That has happened at a time of considerable restructuring within the sector and a large number of the severance payments, particularly in the latter period, have been related to the mergers. Colleges have restructured their management quite considerably in that time with the intention of producing a leaner and differently shaped service, which I think is good value for money.

The Convener: Bob Doris has a final question.

Bob Doris: Time is tight, so I will try to be brief.

There are now rising budgets and a rise in student numbers, but that is from a significantly reduced baseline following the mergers. I asked earlier how colleges are getting a better grasp of student demand in their areas. That issue was flagged up as a concern and there was a key recommendation on it in the Auditor General's report. How does the Scottish funding council work with colleges—for example in Glasgow, the area that I represent—to get an accurate picture of demand? The example was given of a situation in which one student could trigger 10 or 15 applications—the raw data would show that there were 15 demands for a place, but in fact one student needed to be placed.

Laurence Howells: Our key method of working with the colleges is the dialogue that we have through our outcome agreement managers. One of the things that we expect in an outcome agreement is a contextual statement about the situation in that region. Of course, the situation is simplified by having fewer colleges and a more integrated system and in Glasgow, for example, we will be looking to agree with the region a sensible and well-planned curriculum for the whole region that takes into account all the contexts and a range of factors such as population, student demands and the needs of the economy and enables us and the region itself to plan sensibly for its development.

Bob Doris: I am not sure what that means in practice, but I will look back at the *Official Report* to see what you said. Colleges have always sought to work together but there was an impression that in certain areas they were competing with each other for the same students and that the system was not being used as efficiently as it could have been.

With regard to my second question, which is about co-ordination rather than duplication at a regional level, I will highlight a very brief and real example and ask how we might improve the situation. Having completed a national certificate course at a Glasgow college pre-merger, a student might find that they did not have enough credits to articulate to the relevant higher national certificate course; indeed, I have heard stories of students being unable to articulate from HNC courses to higher national diploma courses. The problem was not so much duplication in college regions but the fact that the courses were not articulated with each other. I would have hoped that previously the Scottish funding council would not have funded courses that were not articulated with other courses, but will you now be asking the regions to demonstrate that kind of articulation and progression between courses before you provide funding for them?

John Kemp: What we want to do with regard not just to your example about progression from NC to HNC but to the whole learner journey for those leaving school or entering college then possibly moving into higher education is to ensure that that journey is more joined up. The new regional colleges enable that to happen and give us a tool to do that kind of thing better than we have done in the past—I accept that it has sometimes been difficult to do that previously because a lot of the courses that you are talking about will not have been designed to articulate. For example, many HN courses are designed as an end-point in themselves, with people leaving with a qualification that has value in the market. Increasingly, however, people are using those courses to articulate to other courses and we want to put in place a system that does that better. The bigger regional colleges, the outcome agreements and the work that we are doing with universities will help that situation in the future.

The Convener: Is your question a quick one, Willie?

Willie Coffey: Yes.

I do not know whether you were present when the three college principals were giving evidence, but I asked them about their cash reserves. Since then, I have referred back to the Auditor General's report, which seems to suggest—at least to me—that the £214 million in reserves is actually real money. One of the principals said that it was not real money and that it is not held in any bank account. I have to say that I was a wee bit disappointed by the three principals' approach to some of these issues but I want to ask you the same question that I asked them: is that £214 million real money? What flexibility do the colleges have to deploy those surpluses as they see fit? I believe that Mr Kemp said a minute ago that some of them can be used to fund severance payments, and I have to say that when I pressed Mrs Munckton on the issue of funding for a course that she said she did not receive I was not entirely clear from her response whether she could deploy her own college's surplus funds for that particular course. What is your view on the matter?

Martin Fairbairn: First, I will state the facts. As reported in the Auditor General's report, the balance with regard to income and expenditure reserves at the end of 2011-12 was about £214 million. Separately but coincidentally, the total amount of cash and cash equivalents in the college sector at the same point in time—31 July 2012—was about the same number; however, as I have said, that was almost a coincidence. Is that free cash that is available for colleges to spend on 1 August 2012? The answer is no and Alan Williamson was correct to point out that that cash is to a certain extent committed either specifically or implicitly in other aspects of the colleges' balance sheets. The total cash that colleges had at the end of 2011-12 might have been, as I have said, about £214 million but on the other side of the short-term balance sheet there were commitments of about £135 million to cover money to creditors, overdrafts, obligations under finance leases, hire purchase-type leases and so on and payments that colleges have received in advance from Europe and sometimes from us and which therefore cannot be counted as their money at that point. All of that knocks against the £214 million. All the figures are true, but it all depends on what you are asking about and what particular purpose is in mind at any point in time.

Does that help, Mr Coffey?

Willie Coffey: A bit. Is it real money that we are talking about?

Martin Fairbairn: Yes. We are talking about £214 million of real money.

Willie Coffey: Is it in a bank account or somewhere where it can be accounted for?

Martin Fairbairn: Yes. Of course there are commitments that have to be met, perhaps even the next day.

Willie Coffey: But even within those commitments individual colleges must have some freedom to make certain choices.

Martin Fairbairn: That is correct. Indeed, that is the whole point of having regional boards and individual college boards that assess the needs of their various areas and choose their priorities.

Willie Coffey: Why, then, did Mrs Munckton say that if they did not have that they would all be insolvent?

Martin Fairbairn: I beg your pardon. Can you repeat that?

Willie Coffey: Mrs Munckton said that when this money transfers to the trusts on their becoming public bodies, colleges will no longer be able to access it and will become insolvent.

Martin Fairbairn: This is all getting a bit technical, so you should bear with me for a second. Would you prefer it if I set all this out in writing afterwards?

The Convener: I think so. If the issue is technical and complex, I suggest that you set it out in writing to ensure that there is no dubiety.

Martin Fairbairn: I am not trying to dodge the question but I think that we are getting into technical territory.

The Convener: I had two further questions, one on paragraph 44 of the Auditor General's report about merger costs and the other on paragraph 50 about the time taken for savings, but given the time we will put those questions to you in writing and await your response.

Thank you very much for your evidence. If you think of anything else afterwards, you can always let us know, but it would be helpful if you could follow up the specific point that Willie Coffey raised.

We now move into private session.

13:12

Meeting continued in private until 13:14.

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

Available in e-format only. Printed Scottish Parliament documentation is published in Edinburgh by APS Group Scotland

All documents are available on
the Scottish Parliament website at:

www.scottish.parliament.uk

For details of documents available to
order in hard copy format, please contact:
APS Scottish Parliament Publications on 0131 629 9941.

For information on the Scottish Parliament contact
Public Information on:

Telephone: 0131 348 5000
Textphone: 0800 092 7100
Email: sp.info@scottish.parliament.uk

e-format first available
ISBN 978-1-78392-042-6

Revised e-format available
ISBN 978-1-78392-056-3

Printed in Scotland by APS Group Scotland