The Scottish Parliament
Pàrlamaid na h-Alba

Official Report

PUBLIC AUDIT COMMITTEE

Wednesday 2 October 2013

Session 4

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PUBLIC AUDIT COMMITTEE
13th 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:

Caroline Gardner (Auditor General for Scotland)
Graeme Greenhill (Audit Scotland)
Phil Grigor (Audit Scotland)
Fraser McKinlay (Audit Scotland)
Ronnie Nicol (Audit Scotland)
Mark Roberts (Audit Scotland)
Claire Sweeney (Audit Scotland)
Sally Thompson (Audit Scotland)

CLERK TO THE COMMITTEE

Jane Williams

LOCATION

Committee Room 3

Scottish Parliament

Public Audit Committee

Wednesday 2 October 2013

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

Decision on Taking Business in Private

The Convener (Hugh Henry): Good morning and welcome to the Public Audit Committee's 13th meeting in 2013. I welcome members of the committee, press and public. We have received no apologies. I ask all present to ensure that mobile phones are switched off or at the very least put to silent mode.

Agenda item 1 is a decision on whether to take items 5, 6 and 7 in private. Do we agree to take those items in private?

Members *indicated agreement.*

Section 23 Reports

"Scotland's colleges 2013"

10:00

The Convener: Agenda item 2 is consideration of the section 23 report "Scotland's colleges 2013". Obviously, this issue has been of considerable interest over the past year and more, so the report is timeous. I invite the Auditor General to brief the committee on her report.

Caroline Gardner (Auditor General for Scotland): As the committee is aware, we published a report in October last year that assessed the financial standing of Scotland's colleges immediately before the structural reforms and planned public sector spending reductions took effect. That report also summarised progress towards the establishment of 13 new college regions, with the intention of establishing a position against which the progress of the reforms could be measured later.

In August this year, we published an update report, which covers colleges' financial standing in the academic year 2011-12 and how much learning they delivered. The report also summarises the college sector's recent progress towards regionalisation and examines some of the key issues that colleges are likely to face in the coming years.

We found that the overall financial standing of the college sector continued to be generally sound. Colleges reported an overall operating surplus of £2 million compared with an overall deficit of £29 million in 2010-11, but most colleges continued to operate to tight financial margins, with the amount of the surplus or deficit rarely being more than 3 per cent of their income. Some colleges appear more financially sustainable than others, but there is often no discernible pattern in their ability to achieve a surplus from one year to the next.

Colleges' income has fallen in recent years, and that will continue for the foreseeable future. A £56 million real-terms reduction in grant funding from the Scottish Further and Higher Education Funding Council contributed to colleges' overall income falling by 9 per cent between 2010-11 and 2011-12. The Scottish Government has announced budget increases for colleges totalling around £130 million since 2011, but colleges still face an 11 per cent real-terms cut in revenue funding between 2011-12 and the end of the current spending review period in 2014-15. Some college regions will face larger reductions in funding than others and will therefore need to reduce their costs more.

Colleges achieved their sound overall financial position by reducing spending, mainly on staff. Between 2010-11 and 2011-12, there was a net reduction of around 1,200 full-time equivalent staff, with most reductions in teaching staff. Colleges reduced their recurring staff costs by £56 million in real terms. Staff costs form about 60 per cent of a typical college's spending, so it is understandable that reducing staff numbers is the key way in which colleges have made savings. However, that creates risks, and it is important that colleges retain the right skills and experience that they need to maintain the quality of education that they deliver.

On the issue of regionalisation and reform, most colleges are currently either merging or forming federations with other colleges to create the 13 new college regions. The structural reforms are aimed at helping colleges better to meet local needs for further education and to make savings through increased efficiency. The restructuring represents a major change for the sector. Colleges aim to complete the process as planned by the end of 2013. The total number of colleges will reduce from 37 in 2011-12 to just 21 by the end of this year.

The funding council is providing around £54 million to help to fund regionalisation. Colleges are expected to meet up to half the total cost of individual mergers, but the amount that each college will contribute varies widely. The costs of recent and current mergers have still to be finalised, but the funding council expects the reforms to generate around £50 million in savings each year from 2015-16 onwards. We will monitor colleges' progress on achieving those efficiencies and the other benefits that are planned from the reforms. We will also continue to monitor the sector's progress towards other aspects of structural reform, including the further development of the outcome agreements that set out what colleges are expected to do in return for funding council funding.

Colleges continue to meet their annual targets for providing education, but an increased emphasis on longer courses has led to a reduction in the total number of students who attend college. In line with Government policy, colleges are increasing the emphasis on full-time courses and prioritising education for younger students. That might limit learning opportunities for older people and other groups who prefer to study part time. It is therefore important that colleges monitor the demand for places to help to meet national priorities and local needs for further education.

Finally, following a decision by the Office for National Statistics, all colleges in the United Kingdom will be reclassified as public bodies from 2014. That will require Scotland's colleges to operate within the same system of annual budget limits as other Scottish Government bodies. In turn, that will restrict colleges' ability to build up financial reserves. The Scottish Government and the funding council are currently engaging with the college sector to investigate ways of minimising the impact of reclassification on college finances.

The report makes a number of recommendations to the Scottish Government, to the Scottish funding council and to colleges about what needs to happen to help the sector to address the future challenges. That includes: monitoring progress in achieving savings and the other benefits from mergers to help with financial planning; assessing and managing the impact of reclassification on the financial standing of colleges; identifying risks to future capacity, such as colleges' ability to meet learning needs in the context of reduced staff numbers, and mitigating those risks when necessary; and monitoring the impact of prioritising younger students and full-time courses on the opportunities for older people and other groups and taking appropriate steps to address those needs when necessary.

I intend to produce future reports on progress with reform to allow the committee to keep oversight of how this important policy initiative from the Government is progressing. For now, my colleagues and I will be happy to answer any questions that the committee might have.

The Convener: Thank you. That is helpful. It is also helpful to know that there will a regular look at such a significant issue.

Could you clarify a couple of figures? You said that, in 2010-11, there had been a reduction in income of 9 per cent and that, for the period 2011-12 and 2014-15, there would be a reduction of 11 per cent. Is that 11 per cent real-terms reduction on top of the 9 per cent real-terms reduction?

Caroline Gardner: I will ask my colleagues to clarify that for you, convener. You are right; the picture is complex and there have been a number of shifts in the past couple of years. I ask Phil Grigor to respond to that question on my behalf.

Phil Grigor (Audit Scotland): The 9 per cent is the one-year difference between the 2010-11 and 2011-12 figures. The 11 per cent reduction is the difference between 2009-10 and 2011-12. The longer period of time explains the larger reduction.

The Convener: Paragraph 25 of the report says:

> "A lack of cash can be an indicator that an organisation has financial problems. We therefore asked the auditors of Reid Kerr and Barony Colleges for their views on the colleges' cash position. The auditors told us that these colleges normally operate to tight cash margins and they had no significant concerns over the colleges' financial sustainability."

There are two parts to my question. First, have you had any expressions of concern about the funding position of any colleges in Scotland during the past year or 18 months?

Caroline Gardner: I will ask Graeme Greenhill to pick up on the specific of the question, but it is important to be clear what the cash equivalents figure means. It is only a snapshot of a particular point in time: the final day of the financial year. The auditors of all the bodies for which I have responsibility are asked specifically to make a judgment about whether they think that the body involved is a going concern. There are therefore two tests being done.

Graeme Greenhill will pick up on the question about financial pressures.

Graeme Greenhill (Audit Scotland): I do not think that we have had any indication that any one college is in significant financial trouble.

The Convener: My question was not about significant trouble. I asked whether you had received any expressions of concern at all from any colleges.

Graeme Greenhill: No.

The Convener: On the same page of the report, paragraph 24 talks about

"the SFC's 'good practice' minimum of 60 days' cash"

and Reid Kerr and Barony colleges are again mentioned as having less than one day in reserves. If that is not a concern, why does the Scottish funding council have that standard for good practice?

Graeme Greenhill: The 60 days' cash minimum is intended to give colleges a certain amount of leeway in managing their cash and in the timing for income and paying their bills. Because Reid Kerr, Barony and Carnegie colleges had so little cash at the end of the financial year, we went back to the auditors specifically to ask about how those colleges operated. In the case of Carnegie, it was fairly clear from the accounts why the college did not have a lot of cash. It was less obvious in the cases of Reid Kerr and Barony, and those colleges had a history of not having a lot of cash at the end of the year. According to the auditors, that is basically the way that they operate, and the auditors did not express any concerns about it.

There are potentially some questions about how the colleges manage their cash position. Under the circumstances in which the colleges find themselves, they have to pay close attention to their cash flows and the timing of when they receive money and pay their bills. Generally speaking, that is all manageable. There is a risk if there is a mismatch such that, at any one time, timing differences mean that the college runs out of cash; in that case, it would probably need to have recourse to its overdraft facilities.

That borrowing can be expensive, although it is manageable if it is only for two or three days. If that was a routine approach—if the college had to borrow to support its day-to-day activities—we would not encourage it. In general, borrowing to support capital investment is often a good thing but borrowing to support day-to-day operational activities is rarely a good thing. However, neither Reid Kerr College nor Barony College is in that situation. We are fairly comfortable with the way in which they are operating.

The Convener: We can ask the Scottish funding council why it has a 60 days' cash minimum good practice standard. From your perspective, given that the standard has clearly not been adhered to, is it of any value to have a 60-day minimum standard if it really does not matter that much? Is there a point to it?

Graeme Greenhill: It is guidance. Some colleges, because of the way that they operate, are unable to generate cash.

The Convener: I know that it is guidance, but I am asking you whether there is any point to it.

Caroline Gardner: As accountants and auditors, we all feel that any public body needs to manage its liquidity—the amount of cash that it has available to meet outgoings as they fall due, in the way that Graeme Greenhill has ably described. Guidance is really the only way to put forward what good practice looks like.

Everybody's circumstances are different, and the risks that bodies run are different, depending on their ability to borrow. The funding council's rule of thumb is 60 days, but it can be no more than that. The same is true of the liquidity ratios that are often used in the private sector to consider how liquid a company is.

Mary Scanlon (Highlands and Islands) (Con): I have a supplementary question on the point that the convener made about the 11 per cent fall in funding between 2010 and 2012. I am looking at exhibit 8 and paragraph 31 on page 18 of the report. The fall in teaching in those two years—the ability to offer courses and to deliver education and training—is £69 million, which, as I understand it, is referred to in the statement:

"costs of teaching staff reduced by about 16 per cent".

The figure that you gave to the convener was 11 per cent. Was that for overall college funding, taking into account administration, catering and residential costs? It is the actual teaching that is critical. Can you confirm that the fall in teaching was £69 million over two years—a fall of 16 per cent in colleges' ability in that regard? Is that correct?

Caroline Gardner: We say in paragraph 31, which is above the exhibit that you referred to, that the teaching staff costs reduced by 16 per cent. I do not have the figure to hand, but 16 per cent is certainly the correct percentage reduction.

10:15

Mary Scanlon: That is significant compared with 11 per cent.

I have some further short questions. Before I became a member of Parliament, I was a lecturer in further and higher education and I still see many colleagues in the Highlands. They have been asking me about national pay bargaining, which I understand is due to come in this year.

As Tavish Scott will know, the colleges in the University of the Highlands and Islands tend to languish fairly near the bottom on pay, whereas Reid Kerr College is at the top. People are asking me whether all staff will be moved up to the level of those at Reid Kerr, which would mean that lecturers and staff there would have to go without pay rises for some time. How will national pay bargaining work? Will it mean equal pay for equal work as a lecturer, information technology expert or whatever throughout Scotland?

Caroline Gardner: I am afraid that we cannot help you with that. The focus of the report is on the colleges' annual accounts as they stand and progress on the reform and regionalisation agenda. The committee would need to direct those questions towards either the Scottish funding council or Colleges Scotland.

Mary Scanlon: I understand that lecturers in UHI colleges are paid £5,000 less than those at Reid Kerr College, and many people are concerned about that. I am not a trade unionist, so perhaps you can help me on this, convener. What is your understanding of national pay bargaining?

The Convener: To be fair, I do not think that that is a question for Audit Scotland, although it is clear that implementing national pay bargaining will have financial implications.

Mary Scanlon: Yes, that is my point.

The Convener: I do not know whether the Scottish Government has a role in that or whether it is the funding council's responsibility. We can perhaps find out exactly who is responsible and the financial implications and consequences for each individual college. To be fair, though, it is not a question for Audit Scotland.

Mary Scanlon: Okay. You will understand that people are concerned about the issue.

It feels like only yesterday since we looked at the previous Audit Scotland report on colleges, although I notice that it was in October last year. At that time, I highlighted some points that I do not see covered in the current report, although that is perhaps because I have not read every word.

One issue that I raised as a concern last year and which is not covered in the current report—I hope that this is appropriate—is that the pension deficit in the college sector had increased sixfold since 2007. In 2007, it was £10.8 million and, last year, it stood at £60 million. I would have thought that it is appropriate to raise that issue as we move towards merging colleges. Am I right that the issue is not mentioned in the current report? Is it still a concern, or has it been addressed?

Caroline Gardner: It is still a concern and we have addressed it in the current report. It is a long and complex report, so do not worry that you missed it. In paragraph 19 and the following paragraphs, the report talks about the pension deficits. We show that, broadly, between 2010-11 and 2011-12, the deficit on the pension reserves almost doubled to £115 million.

Mary Scanlon: Oh gosh—it is even worse than I anticipated.

Caroline Gardner: I can talk you through what is behind that. Two things that have affected the valuation are, in effect, prudent accounting adjustments that reflect the current state of the financial world. First, we have seen a reduction in the assumed rate of return on the funds that are invested, which is no surprise, and, secondly, there is a reduction in the discount rate, which has the effect of increasing the valuation. A third factor is that more further education staff have been taking early retirement, which causes a real increase in the deficit in the pension reserve. Three things are going on that all have the impact of increasing the deficit.

We would make the same point that we made last year, which is that these are long-term liabilities that certainly need to be managed but which will not have an immediate impact on any individual college or on the sector as a whole.

Mary Scanlon: Okay. Sorry that I missed that one.

My final—

The Convener: Sorry, but before we move on from pensions, I ask the Auditor General to clarify something.

Paragraph 19 states that teaching staff are usually members of the Scottish teachers superannuation scheme and that some others will be in the local government pension scheme. Those are both national schemes. Why does each college have either a surplus or deficit in its pension scheme if staff participate in a national scheme? Is the national scheme divided up between colleges?

Caroline Gardner: In effect, the schemes are divided into separate pots for each of the main employers that are part of them. I ask Graeme Greenhill to talk you through how that works in more detail.

Graeme Greenhill: As you say, convener, there are two main pension schemes that college employees are members of. The Scottish teachers superannuation scheme is an unfunded scheme, so colleges basically make contributions to the scheme to cover the future cost of their pensions. In respect of the local government pension scheme, there are actually several local government pension schemes across the country, and the local college tends to belong to the local scheme in respect of its non-teaching staff.

The local government pension scheme is a funded scheme—that is, the money that it collects is invested in stocks and shares and so forth. Under the accounting rules, colleges account for their share of the scheme in their own accounts in exactly the same way as, for example, the local authority will account for its pension costs. A college's accounts will show both its share of the assets of the overall pension scheme and its liabilities.

The Convener: So with neither scheme is there the possibility that a particular college pension fund will go bust or there will be a problem. They are all part of a bigger scheme and they are merely accounting for it. You state the figure of £9.6 million for James Watt College, but in terms of the pension fund, that is neither here nor there. The impact is on the college accounts.

Graeme Greenhill: If the pension scheme went bust, as you put it, it would not just be the particular college that would lose its share of the assets and liabilities, but every other member of the scheme as well.

The Convener: Equally, in terms of meeting future liabilities, there is no greater financial burden on James Watt College given the health of the pension scheme. All the colleges would share in the contributions to the pension scheme.

Graeme Greenhill: That is correct. That is the kind of thing that actuaries routinely look at, and depending on how the pension scheme is performing, they might require members of it to increase their contributions to the scheme to address any liabilities.

The Convener: Mary, do you have another question before I bring Bob Doris in?

Mary Scanlon: Yes—just a brief one. Again, I raised it last year. The first set of outcomes last year was about the amount of learning and structural change. It included:

"a greater focus on colleges' contribution to the development of a highly educated and skilled workforce."

I was slightly disappointed when I saw that one of the five outcomes in paragraph 54 of the 2013 report is:

"improve the quality of education so that 1,000 more full-time students successfully complete their courses".

I would not see 1,000 students finishing their courses as an indication that the quality of education had increased across the board. Is there sufficient emphasis on the quality as well as on the finances?

Caroline Gardner: I ask Ronnie Nicol to talk you through what we know about the development of outcome agreements.

Ronnie Nicol (Audit Scotland): We recognise that the development of outcome agreements is a bit of a journey for all the public bodies that are involved in that across the public sector. When we looked at the initial ones last year, we felt that they were fairly basic. They were focused on the planning and structural reform aspects. We have seen some movement this year, and that is particularly supported by some work that was done by Education Scotland for the Scottish funding council. We are seeing more focus on what we might call outputs rather than outcomes. We see that as at least some progress towards where we want to be in seeing those agreements managing longer-term benefits as a result of the education process in colleges.

Mary Scanlon: Do you understand that, to anyone who reads that outcome, there is not a lot of focus on quality? It focuses more on the finances.

Ronnie Nicol: That is why we have recommended that attention needs to be paid to continue to develop the outcome agreements.

Bob Doris (Glasgow) (SNP): I was looking at the part of the report about outcome agreements while Ms Scanlon was talking about quality. One of the targets is:

"improve the quality of education so that 1,000 more full-time students successfully complete their courses".

Quality is therefore an inherent part of the outcome agreement. I happened to be looking at that page as Ms Scanlon was making her comment about quality.

I am interested in outcome agreements and community planning, but I have another question first.

On page 34 of your report, in paragraph 74, you mention colleges' application processes, and the recommendation on page 35 states that colleges should "implement the Scottish Government's recommendations to improve the application process to help monitor the demand for college places."

Some more information on that would be welcome. If a student decides to undertake a course in construction—be it in bricklaying, joinery or whatever—and applies for a place at North Glasgow College, City of Glasgow College and another college, that may show up in the figures as a demand for three college places, although it is just one student exercising a range of choices. How is that audited? The current process may capture the range of desires that students have, but it does not reflect the demand for college places. As we try to identify the number of college places that are needed, would it not be better to have a more sophisticated system that could track the demand from students? I hope that your recommendation is partly to do with that. Politicians of all parties sometimes talk about unmet demand in the sector, but we are not necessarily reflecting the number of students who are seeking courses at colleges, as students may apply for several courses. Some more information on that would be welcome.

Caroline Gardner: You are right. That issue has received a lot of attention over the past year and the Government has recognised that we need better information about the real level of need and demand rather than about the level of applications, which may not reflect either. I think that the question about the progress that has been made is for the Scottish funding council and the Government, but Phil Grigor will update you on what we know about the progress that has been made to date.

Phil Grigor: Paragraph 74 was written on the back of two separate surveys that produced widely differing results in terms of the demand for college courses. The report that the Government published in March made several recommendations for working with the likes of the funding council, colleges and Colleges Scotland to monitor and manage the demand for places so that multiple applications from a single student are not double counted, giving the false impression of unmet demand. That is why, in our report, we made the recommendation for colleges to work with the Government and the funding council to establish a more robust measure of the demand for college places.

Bob Doris: I see the importance of that. Could the Government and the funding council have based the range of college courses that they wanted to be developed—be they part time or full time—on false assumptions based on the number of applications rather than the number of students seeking college places? Was there poor practice previously, and do you see this as a necessary step towards better planning of the college sector?

Caroline Gardner: We would certainly say that it is a necessary step to take, particularly given the importance that FE has in the Government's employability agenda, which is central in the current economic climate, and the regionalisation and reform agenda, which means that we should be planning on a much more regional basis. I cannot go as far as to say that planning was, in the past, based on poor information. The applications were part of the information that was used by individual colleges and the funding council, but they were only part of it. We know from the two studies that Phil Grigor referred to that different sets of assumptions were at work. It is not the subject of this audit, but it may be an issue that you would like to explore further with the funding council and the Government.

Bob Doris: That is helpful. I have a final question. I started by talking about community planning and agreed outcomes. How does the recommendation on page 35, about properly gauging the demand for a college or region, feed into or link with community planning? Is there a link, or is there work in progress to ensure that there is alignment between college provision and community plans within a region?

10:30

Caroline Gardner: That is still very much work in progress. In May, I published a report jointly with the Accounts Commission on progress with community planning. One of our findings was that FE reform and other parts of the public service reform agenda are not always closely aligned with community planning.

Given the refreshed approach to community planning and the single outcome agreements, we expect a much clearer line of sight from the priorities for an area through to the targets and outcomes that are agreed for an individual college or college region, so that we can see how action that is taken in the FE sector contributes to local community planning priorities and to the national priorities that the Government has set. That is still work in progress.

Bob Doris: If I am lucky enough to be a member of the Public Audit Committee in three years' time—I say that with some irony—should I expect to see much closer correlation between community planning and how colleges design and promote courses for communities in their areas?

Caroline Gardner: The short answer is yes. We will be able to give you evidence on that from two ends of the telescope: the reports on community planning, which we will continue to produce; and the reports on further education and employability. We should start to see things joining up much more clearly than they do at the moment.

Colin Beattie (Midlothian North and Musselburgh) (SNP): On page 9, under the heading, "Key messages", you said in paragraph 2:

"there is often no discernible pattern in colleges' ability to achieve a surplus".

I am having a bit of trouble with that. A college will have a business plan and a budget, and to a large extent its cash flows in and out will be predictable, but it seems that whether it has a surplus or a deficit is almost random.

Caroline Gardner: I think that what we said reflects the comment that we made in the same paragraph about the tight margins within which most colleges operate. That means that although colleges have plans, financial controls and all the things to which you referred, they are quite vulnerable to short-term changes. Whether such changes could have been foreseen or not is always difficult to know, but an upturn or downturn in student numbers or funding, or an unexpected charge coming through, can have a marked impact on colleges' ability to make a surplus or a deficit.

Colin Beattie: We are talking about very small changes having such an impact.

Caroline Gardner: Exactly. Most surpluses or deficits were within 3 per cent of income—Phil Grigor will tell me if that is not correct—so it does not take much of a shift in income or expenditure to switch from a surplus to a deficit.

Colin Beattie: Given your comments in paragraphs 17 and 25 on page 13, will you confirm that there are currently no concerns about the financial position of the colleges that are listed?

Caroline Gardner: The auditors who audit colleges are required to give an assurance about going concern, and they have done so in each case as part of their audit for the 2011-12 financial year. At the same time, we say in the report that there are significant challenges for the sector as a whole, which need to be carefully managed. In strict accounting terms, there are no concerns about going concern, but, as the report says, there are challenges that will need careful management by the colleges, the funding council and Government.

Colin Beattie: There is a pension deficit of £115.3 million, which is an awful lot of money. In paragraphs 20 and 21 you seem to say that the deficit is sustainable in the short term. When does it become a problem? At what point do the colleges get a gun put to their heads and told to put money in?

Caroline Gardner: I do not think that there is a particular date at which that will happen. The benefit of valuing pension assets and liabilities in a transparent way, as the financial reporting standards now require, means that the scale of the problem that needs to be managed over a long period becomes more apparent.

There are two things to say. First, the position is sensitive to small changes in the assumptions for the discount rate and the rate of return on investments, where that is applicable. Secondly, a range of responses can be made. In paragraph 21 we highlighted some of the changes to pension schemes that the UK Government is proposing, to bring assets and liabilities back into balance. As Graeme Greenhill said, there is also a process by which the actuaries for each scheme make recommendations to the scheme as a whole and to individual scheme members—individual colleges—about the contributions that they should make. We are keen that this committee, the Government, the funding council and colleges keep an eye on the liabilities and ensure that over time things move in the right direction.

The Convener: I just want to clarify this. If colleges are asked to pay, for whatever reason, extra into the pension funds in the future, would that be at the same time that all local authorities would also have to make additional contributions for the members who would make up the vast bulk of contributors?

Caroline Gardner: I will ask Graeme Greenhill to keep me straight here, because pension accounting is very complex and I am not an expert in it. I think it operates at two levels. For the scheme as a whole there is a triennial review of the level of contributions made by members, rather than by the public bodies, to make sure that they are keeping pace. For individual colleges and other members of the local government pension schemes, there can be a requirement to make additional payments to reduce the scale of their deficit over time.

The Convener: Would there be a different payment for each individual body?

Caroline Gardner: That is certainly the case for some members of the local government pension scheme. It is the case for Audit Scotland in respect of our staff who are members of the scheme. Graeme, do you want to add to that?

Graeme Greenhill: Caroline Gardner's analysis is spot on. One of the reasons why the pension scheme administrators try to identify each member's share of the assets and liabilities of the pension scheme is so that any difference in liabilities can be addressed through changes to the contribution rates.

The Convener: That takes me back to a question that I asked earlier. James Watt College, which is now part of West College, was mentioned. For argument's sake, if there was a concern about the pension pot at James Watt College, or indeed West Lothian College or any of the colleges, could it be asked to pay over and above what other contributors are having to pay?

Caroline Gardner: I will caveat this by saying that we will need to confirm it with you afterwards, convener. Our understanding is that in relation to the historical deficits for an individual member, for the liabilities that are already built up, as opposed to those that are forecast to build up in future, the local government scheme allows for a specific additional payment to reduce the deficit from the contributing body—the individual college, or, in future, the new merged college, to which you referred. We do not know whether that is actually the case for any of the colleges across Scotland, such as the one to which you referred, but it is a possibility and it happens in relation to current members of the local government scheme.

The Convener: Concerns have been expressed about college management over the years, such as that generous remuneration packages were offered with significant pension pots on offer and enhanced payments were made for early retirement, which would have a specific burden on an individual college, which it or its successors could have to pay. In other words, the managers who were party to encouraging those responsible in their colleges to look at enhanced pension provision for the senior staff could well benefit from it but leave with a package and not have to worry about who would have to pay for it in the future.

Caroline Gardner: I cannot comment on the specifics that you are referring to, but it is obviously the case that for any member of one of the public sector pension schemes, past decisions about retirements and early retirements will have an impact on future liabilities. Our understanding is that that can affect both the overall levels of scheme contributions and the levels for individual members. One of the reasons for the Accounts Commission's reports on managing the local government pension scheme in particular is to make sure that early retirement decisions are made in full knowledge of the likely impact of those costs.

The Convener: I remember hearing complaints about what was going on at James Watt College prior to the merger, when the salaries and pension packages of senior staff were enhanced considerably. Indeed, just before the merger I think, the principal of James Watt College was on what was termed gardening leave for between six months and a year before leaving with a very generous package. Is it the case that the successors would have to bear the burden of the generous provision made by those in James Watt College at the time?

Caroline Gardner: Again, I cannot comment on the specifics. It is not what we have audited in the report. I reiterate the point that past decisions made about early retirement will have an impact on the future costs of the pension schemes and the future liabilities.

The Convener: Perhaps that is something that we could inquire about.

Colin Beattie: Turning to exhibit 7 on page 17, I notice that, between 2010-11 and 2011-12, administration costs increased. Does the figure include an element of the cost of the mergers or is it that the administration costs have, in fact, gone up, which would not be right?

Caroline Gardner: I will ask Phil Grigor to talk you through what more we know about those figures, which are taken from the annual accounts.

Phil Grigor: We do not have the details of what the administration costs involved, but a large part of the merger costs were spent on staff severance packages and that is one of the ways—in fact, it is the main one—in which colleges are achieving their savings from one year to the next.

Colin Beattie: So we do not actually know what is contained within that figure.

Phil Grigor: No, we have not drilled down to that level of detail from the accounts.

Colin Beattie: It just stands out.

The Convener: As does the other figure, which is "Other inc. exceptional costs".

Phil Grigor: The exceptional costs could include staff severance packages. It is unlikely that the administration costs include that.

Colin Beattie: Unfortunately, it seems to be speculation as to what those costs comprise.

The Convener: Is there a way of finding out?

Caroline Gardner: It is not speculation, convener. As the report tries to make clear, it pulls together the accounts of all the colleges throughout Scotland as an exercise in demonstrating what is changing.

It is possible for us to explore the matter further for next year's report if you have an interest in it and, if the committee wishes, to explore further with the funding council what it knows about the costs of mergers and how they are being funded.

The Convener: Is there a way to find out how much colleges cumulatively paid on packages between 2010-11 and 2011-12?

Caroline Gardner: I ask Graeme Greenhill to pick that question up.

Graeme Greenhill: If the committee is interested in pursuing the matter, we could probably do a little more analysis, break down exhibit 7 into a little bit more detail and explore some of the issues that have been raised.

The Convener: Yes, that would be helpful. Thank you.

Colin Beattie: How will the change in college status that is coming up affect the borrowing powers of colleges?

Caroline Gardner: Graeme Greenhill is keeping a close eye on that for us, so it is back to him again.

Graeme Greenhill: The consequences of college reclassification largely fall into two camps. One is the consequences of the change in the colleges' accounting year. That is largely procedural and manageable. Perhaps more challenging are the consequences of colleges becoming part of the Scottish Government's overall budgetary control regime. Under the current system, what counts as college expenditure is basically what the funding council gives colleges in the way of grant. From April 2014, all college expenditure, regardless of how it is funded, will count as expenditure within the Scottish Government's budgetary control regime.

To cut to the chase, the Scottish Government has an annual budget limit and the change means that that limit will also apply to colleges. Therefore, in future, if colleges incur a deficit, they will require annual budget cover. Basically, that means that the Scottish Government will have to find savings from elsewhere within its budget to support them. If they make a surplus in any one year with the intention of using it in future years, the surplus will count as an underspend in the year in which it is made, but the future spend will require budget cover. If they wish to use their current cash reserves to support their activities in the future, that will require budget cover. Equally, if they borrow to support capital investment, for example, that expenditure will require budget cover.

Those are quite significant changes. The sector, colleges, funding council and the Government are looking at how best to mitigate the effects of the ONS's decision to ensure that colleges still have that flexibility to manage their reserves and annual surpluses. They are considering various options for how best to do that. It is still early days and no college has come out with any firm proposals for how it intends to do that, but we will keep an eye on the situation as the months pass. It is the sort of thing that we will be expected to say more about when we produce subsequent college reports.

10:45

Colin Beattie: Your answer alarms me more than the original question did. Colleges obviously have facilities that enable them to manage their cash flow. Will they be able to continue with that? It will be quite awkward if they cannot.

Graeme Greenhill: Colleges will still be able to manage their cashflow. The main challenge for the colleges is how they retain access to their current level of reserves and how they will be able to use any surplus that they make from year to year.

Ken Macintosh (Eastwood) (Lab): One of the figures that jump out at me is the one that shows that in 2011-12, 48,000 fewer Scots went to college. During the three years up to then, about 100,000 fewer Scots went to college. Is that correct?

Caroline Gardner: The figure for the current year is certainly in the report. I am not sure whether we have the three-year figure to hand.

Ken Macintosh: I am just looking for the page.

Caroline Gardner: Could you give me the page reference please, Mr Macintosh?

Ken Macintosh: Pages 18 and 19. I think that paragraph 32 suggests that 48,000 fewer Scots went to college in that one year. The chart makes it look as though 100,000 is roughly right.

Caroline Gardner: We would have to confirm the three-year figure. It is important to say that that change reflects a specific Government policy choice to focus on 16 to 19-year-old students and full-time courses rather than shorter or part-time courses. That is linked to the Government's policy objectives for employability and it clearly has consequences for other groups, as I said in my introduction. It is important that the impact on those other groups is monitored and action is taken where necessary.

Ken Macintosh: The figures for the number of people going to college that I am quoting are quite dramatic, are they not?

Caroline Gardner: As I say, the natural consequence of the Government's policy choices is more younger and full-time students, and fewer older and part-time students. When you convert that into a head count, it reflects a reduction in the number of people who are at college but, within that, there is a retargeting of younger and full-time students rather than other groups.

Ken Macintosh: There was a cut of £56 million in that one year, which led to the drop of 48,000 students. That was a 9 per cent cut and you suggest that there is an 11 per cent cut to come. Are you suggesting that there will be a further fall in the number of Scots going to college because of that?

Caroline Gardner: That is a question that you will need to take up with the Government and the funding council. What we have set out in the report is the figures for further education funding that we have from the Scottish draft budget for the two years ahead. We know that the Government's current policy is to focus on 16 to 19-year-olds on full-time courses. It is not possible for us to draw a clear line of sight between the two, but you might want to explore that with the Government or the funding council.

Ken Macintosh: Just over 1,000 full-time equivalent staff, which is probably more than 1,000 people, have lost their jobs.

Caroline Gardner: It is 1,200.

Ken Macintosh: Yes, 1,200 people have lost their jobs. You point out that colleges have dealt with the majority of the cuts by getting rid of staff, and you suggest that another 11 per cent cut will follow. Can you see any way of not laying off more lecturers?

Caroline Gardner: How individual colleges respond to the reduction in funding that is available for further education is a matter for them in discussion with the funding council. Obviously, the other bit of the jigsaw is the outcome agreements that colleges have and the targets that they sign up to on, to use the jargon, weighted student units of measurement—that is a horrible phrase, but the aim is to standardise and take account of different types of students doing different courses. The committee would need to explore that with the funding council and the Government if it wants to know more about the issue. It is clear that the Government is operating within a UK-wide climate of financial austerity, which requires choices to be made in the budget that are outside my remit. The focus of the report is on making transparent the figures for the further education sector, as we do for the health service and other sectors, as a basis for holding the Government to account.

Ken Macintosh: Indeed. Bear with me, because I am trying to work this out. Given that there has been a 9 per cent cut and we have lost 48,000 students and 1,200 staff, and that we are going to get an 11 per cent cut, how can colleges do that without cutting staff or the number of students or both? Do they have anything else at their disposal that they can do?

Caroline Gardner: I have two things to say, without answering the question on how they will and should do that. First, we know that staffing accounts for about 60 per cent of the colleges' costs, so it is clear that they will have to look at that as part of managing the reduction that they face. Secondly, the Government and the funding council see the reform agenda not just as a way of increasing the quality of education but as a way of generating efficiencies that can help to balance the available funding with the objectives for education. Obviously, a range of things within that mix are unknown, but you might want to explore with the Government and the funding council their plans for how that circle will be squared.

Ken Macintosh: I am just trying to think what it could be. Could it be more students in the classroom or fewer hours per student?

Caroline Gardner: You really have to explore that question with the funding council. There is a range of questions on the efficiencies that could be generated from the reform agenda. They will be different in different parts of the country and in different circumstances.

Ken Macintosh: You have given us a good analysis of the figures, but do you make any analysis of the impact on the quality of education? Given that staffing accounts for 60 per cent of the running costs, it looks as though the staff have borne the brunt of the cuts so far. You say that colleges as institutions are efficiently run on a financial basis, but do you make any comment on the capacity of colleges to absorb the level of cuts without that affecting the quality of education or the number of students who are taught?

Caroline Gardner: We are clear in the report that it is a work in progress and a review of how the reform agenda is being taken forward and the impact that it is having on expenditure, student numbers and other indicators. We will keep that under review. In due course, it might be appropriate to do a full assessment of the reform and how it has worked out. I am not making a commitment to do that, but we will certainly keep the issue under review as part of the updating of our work programme. The funding council and the Government are and should be monitoring the impact of the reform agenda and comparing it to the plans that they made. The committee might want to explore that with them while it is still a work in progress to get more information from them about the impact that they expect and how they are monitoring the effects on quality as well as on costs.

Ken Macintosh: While we are on that, are you aware of any forecasts that the Government and the funding council are using on student numbers or staff numbers?

Caroline Gardner: That is very much a question that you would have to ask of the funding council and the Government.

Ken Macintosh: I want to go back to the issue of reserves, which colleagues have touched on. On page 12, you say that the colleges currently have about £214 million in reserves. A couple of colleges have had trouble. For example, Forth Valley College's deficit has increased substantially. At paragraph 13, you state that "staff severance costs associated with planned restructuring"

amounted to £1.1 million. It strikes me that the restructuring and regionalisation programme has been paid for out of reserves. Is that right?

Caroline Gardner: For some colleges, that certainly is the case. It was the plan that some colleges would contribute from the reserves towards the cost of restructuring. Others are receiving direct support from the funding council. In paragraph 17, we provide a bit more information on the three colleges with deficits in their income and expenditure reserves.

Ken Macintosh: Again, you might not know the answer to this, but I thought that the Griggs report specifically recommended that colleges should not use reserves for restructuring.

Caroline Gardner: I am not aware of that recommendation, but in the report we talk about the differences in the extent to which colleges and college regions are expected to contribute towards the cost of the reforms. That reflects local circumstances and the level of reserves that are available to them.

Ken Macintosh: From next April, when colleges become public bodies again under the ONS recommendations, will the Government be able to access the college reserves? I ask because, last year, after the police forces were restructured, the Government basically took what was in the police reserves and used it as Government money. I take it that the Government can and probably will do that again. Do you expect it to do so?

Caroline Gardner: Graeme Greenhill has outlined some of the potential impacts on colleges' finances of their reclassification as public bodies. One is that surpluses that colleges generate count against the overall Government spending limits. A lot of work is going on to manage the impact of that and to consider the available options. We cannot second-guess what the outcome of that work will be.

Ken Macintosh: Do you expect the Government to take the money—the £214 million—now that it can get its hands on it?

Caroline Gardner: I am not sure that I would frame the question in that way. It is public money in any case and there are important decisions to be made about the way in which it should be used in relation to the FE sector, individual colleges and wider priorities. Those decisions are well outside my remit. In the report, we have highlighted the potential impact that the change in classification will have on the overall financial framework for colleges.

Ken Macintosh: On good financial planning, we recently had a debate about trying to move to three-year funding more generally for the voluntary sector. However, colleges are moving away from advance planning to annual budgets. If the Government takes away their £200 million of reserves, will that help their ability to plan for the future?

Caroline Gardner: Again, I would come at the issue slightly differently. My report last year on national health service finances made the specific point that the annual targets for individual health boards make it harder for them to take a longer-term approach to financial planning. That issue affects not only health boards but all the bodies that are part of the public sector financial framework. There are good reasons for it, but my recommendation was that the Government should consider ways of encouraging and supporting longer-term financial planning. The same issue potentially applies to FE colleges on the back of the ONS reclassification.

Ken Macintosh: I have two brief further points, convener.

The Convener: They will need to be very brief, because we are starting to run out of time.

Ken Macintosh: On staff severance payments, I notice that, over the past years, there has been continuing use of compulsory redundancies in the college sector, despite there supposedly being a Government policy against that. There has also been increasing use of compromise agreements. To give you the figures, which come from my freedom of information requests rather than your report—if I may say so, the figures in your report are higher than those that I got from my FOI requests—there were nine compromise agreements in 2007-08, 24 the next year, then 73, 117 and 146 in following years and 411 last year at a cost of more than £1 million. That strikes me as a worrying trend. Have you picked up on that and would you caution against it? Do you expect colleges to be wary of that?

Caroline Gardner: In paragraph 30, on page 17, we talk about the amount that was spent on staff severance payments in 2011-12 as we have taken it from the accounts. That was £21 million. I do not recognise the figures that you have and I am not surprised by that, given the different sources and the potentially different ways in which colleges are managing the reduction in staff and the broader reform agenda.

It is important to say that, if the reform agenda is to generate efficiencies in the way that is proposed, it is likely that there will be either reductions in staff numbers or changes in the balance of staffing to ensure that future needs can be met. It is important to me that those changes are transparent to the Parliament and to others with an interest. The report is a contribution to that but, as we say clearly, it is not the whole story, because it is a work in progress. We are keeping a close eye on the issue and, in future, I will consider whether there is value in bringing a further report back to the committee. For now, we have the information from the colleges' accounts for 2011-12. The broader question of the way in which colleges are managing the balance between efficiency and quality is one to explore with the funding council and the Government.

Ken Macintosh: You have produced a report that highlights the use of compromise agreements and warns against their misuse. Their use is clearly on the increase. I made FOI requests to all the colleges about compromise agreements and found that there has been a quite dramatic increase from nine to 24 to 73 to 117 to 146 to 411. That is not just a dramatic trend but a worrying trend that is going in the wrong direction. Does that flag up any warnings to you at all?

11:00

Caroline Gardner: We were very clear in the report that, in reducing the size of the workforce through early departures from the public sector, there can be a role for compromise agreements. They can be used to protect both parties to an agreement from future legal action, for example. We are also very clear that compromise agreements should not be used to gag whistleblowers or to hide concerns about how public bodies have managed particular situations. The trend in itself does not concern me, but the way in which compromise agreements are used is obviously very important and is a matter of public interest. It is something that you may wish to explore with the funding council.

Ken Macintosh: A constituent wrote to me because they were concerned about the cost of the City of Glasgow College's capital programme in particular. They suggested that it will have an impact on the capacity of the overall college sector in Glasgow. Is it within your remit to look at such an issue and, if so, have you done so?

Caroline Gardner: I have also had a query about that particular investment project. As part of our general responsibility to understand how public money is being spent and to be aware of issues that may be of concern, the auditor is looking at that for me at the moment. However, I do not have any further findings to report back at this stage, I am afraid.

Tavish Scott (Shetland Islands) (LD): My apologies for being late, convener. If Caroline Gardner covered this point in her opening remarks, please let me know.

I want to try to understand the financial governance landscape in the college sector so if I get this right, tell me. We have the funding council, then we have regional boards and then we have college boards. What is the relationship between those three bodies and who drives the process?

Caroline Gardner: I will ask Ronnie Nicol to answer that. It is still very much a work in progress, but I think that we can give you an outline picture of it.

Ronnie Nicol: The Scottish Government expects the funding council to manage overall the money that is given to individual colleges. Those colleges are now being directed through the regions. It is a work in progress. The links between the funding given and what is delivered from the college sector is being managed by the outcome agreements which, as we said earlier, are in their early stages and need to be developed and improved. That is the basic outline.

Tavish Scott: Who sets the outcome agreements?

Ronnie Nicol: The funding council requires college regions to produce the outcome agreements for their areas. They have to respond to specific things that the funding council asks them to include.

Tavish Scott: Where does an individual college fit into that—or does it not fit into that at all?

Ronnie Nicol: Individual colleges would be represented on the regional boards.

Tavish Scott: By whom?

Phil Grigor: The arrangements for establishing the regional boards are in progress just now and there has been correspondence from the Scottish Government to the regional boards to outline some transitional arrangements before things are finally in place next spring.

Tavish Scott: So this is all meant to be in place by spring 2014.

Phil Grigor: Yes. The aim is to have the regional chairs and the regional boards in place by May next year.

Tavish Scott: Does that mean that regional boards will then divvy up the money that is allocated to a region for the purposes of providing college places across that region? Sorry, I appreciate that "divvy up" is not a very good accounting phrase.

Caroline Gardner: "Divvy up" is not the phrase that we would use, but the aim is that the regional board will pull together each of the colleges in the region, agree a picture of what the needs and demand are in that area and then agree how between them the colleges will meet those needs or demands with the funding that is available from the funding council.

Tavish Scott: How are you going to audit that? I am sorry, as this is all about the future, but will Audit Scotland therefore be auditing the regional boards rather than individual colleges?

Caroline Gardner: We will be auditing the groupings that make up the accounting entities, if I can put it that way. In most cases, that will be the new colleges—the merged colleges. The regional boards are a planning and resource allocation mechanism between those colleges and the funding council.

Tavish Scott: Audit Scotland previously audited the relationship between the funding council and colleges; now there is another structure in the middle of that, which will, in effect, be where all the decisions are taken once the regions have received their allocation from the funding council. Is that a fair summary?

Caroline Gardner: The regional boards will have a role between the colleges and the funding council in agreeing the resource allocation. We track the money, so we can audit the system as a whole, we can audit the funding council and, in most cases, we can audit the new merged colleges that are spending the money. However, because I have the section 23 powers that let me carry out reports like this one, we will still have oversight of the whole system if we think that there is an issue there that is worth investigating.

Tavish Scott: If an individual college, wherever it might be in Scotland, ultimately feels that it did not win, or simply was unsuccessful, in its application for funds to the regional board, would you still be able to look into that in order to assess why that college had failed on student numbers, or other Government targets—which of course are set at the centre—and so forth?

Caroline Gardner: Yes. One of the benefits of the public audit model in Scotland is that it is joined up and we can look at a situation at whatever level of aggregation is most useful.

Tavish Scott: Right. That is very helpful. As regards Ken Mackintosh's point about the Griggs review, you covered that in paragraph 43 of the report, if I read it correctly.

Also in paragraph 43, Audit Scotland points out that when individual colleges have the money,

> "the Scottish Government would expect colleges to use their financial reserves to meet"

a proportion of their merger costs, or in your terminology,

> "a significant portion of their merger costs".

What happened when colleges did not have the money?

Caroline Gardner: Some funding is available from the Scottish Government, through the Scottish Further and Higher Education Funding Council, for mergers. The question is bigger than just whether colleges have the money. It is about what the overall state of development of FE looks like in a region, what funding is available, to what extent that is earmarked for capital investment, and therefore what needs to be provided by the Scottish Government.

Tavish Scott: I do not really understand that. I thought that paragraph 43 was specifically about meeting the cost of all the mergers. I did not realise that it was about all those wider factors as well.

Caroline Gardner: Paragraph 44 is the one that aims to explain what is happening. For each merger, a plan sets out the likely costs. There is then an agreement between the funding council and the colleges involved about how those costs will be met, which will reflect the amounts that are available in reserves but also the extent to which those reserves are already intended for capital investment.

Tavish Scott: Okay, but if a college in a region did not have any reserves, was the merger—the pulling together of the colleges—funded ultimately by the Government, in effect?

Caroline Gardner: Yes.

Tavish Scott: Okay. Thank you.

Paragraph 47 talks about the merger of three colleges to form the City of Glasgow College and mentions:

> "In May 2013, the SFC reported that the merger had delivered savings of about £5 million so far, and that the college had estimated total savings of over £26 million between 2010 and 2015."

Is that £5 million in savings a work in progress and do you expect the £26 million savings target to be met?

Caroline Gardner: You will notice that the wording there is careful. We have reported what the Scottish funding council has reported and what it expects. We have not evaluated the costs and benefits of reform yet. We may do that in the future. The committee may wish to explore that point with the funding council.

Tavish Scott: The whole point of the merger programme and centralisation of colleges—as you said in evidence earlier to the committee—is to save money. If it has not happened in the case of the City of Glasgow College—and your correct wording on that is that the figures are the funding council's observations—something is not going very well, is it?

Caroline Gardner: I am saying that we have not yet carried out that evaluation and that it is something that the committee may want to explore with the funding council. We may well explore the matter in the future, but that is not what the report that we are discussing aims to do.

Tavish Scott: As one humble member, I think that you should look into that.

Caroline Gardner: Thank you; I hear you.

Mary Scanlon: I have a brief supplementary on Mr Nicol's point to Tavish Scott. My understanding is that in the Highlands and Islands, the funding stream is different in that the funding for colleges is filtered through UHI and that that filter costs £15 million. That was not mentioned. Several of the colleges are concerned that they may get a lower level of funding per student than colleges elsewhere in Scotland. Is that a concern of yours?

Caroline Gardner: It is the case that the arrangements are different in the Highlands and Islands because of the existence of UHI. I cannot comment on either the cost of that arrangement or what the impact may be in the future. That, too, is something that you may wish to explore with the funding council. We would pick it up in evaluating the progress of the reform, if we do that in the future.

Willie Coffey (Kilmarnock and Irvine Valley) (SNP): First, on the issue that was being discussed a wee moment ago about the reserves, I had a look back at an Audit Scotland report from 2008—five years ago. At that time, the college reserves stood at £100 million. Now, they are standing at more than £200 million. I think that it is reasonable—I think that the public would expect it—that the colleges make some kind of contribution to regionalisation, given their substantial cash reserves.

My question in that regard is about the move to public body status, which has been mentioned a few times. What is the likely outcome of that for the colleges' cash reserves, given that they will be restricted in their ability to build up such reserves? Where is the money likely to go? Will it go into further capital investment?

Caroline Gardner: As Graeme Greenhill said, the Government, the funding council and colleges are examining a number of options for how the issue of reclassification might be resolved, and all the options have pros and cons. Our interest is in ensuring, first, that they are transparent and that it is clear what has happened to that significant amount of public money that has been built up over a period. Secondly, our interest is in ensuring that the mechanisms that are put in place enable colleges, and the sector as a whole, to plan for the investment that is needed for the longer term.

Also we want, in a wider sense, to ensure that the way the money is treated enables the Government as a whole, and the further education sector, to make good decisions between competing choices, and to prioritise rather than to go for short-term decisions because that is expedient. Those are the criteria that we will apply in examining the resolution that is reached. However, it is too soon to talk about the decision that the funding council and the Government might take.

Willie Coffey: Looking back on the five-year period that we have just come through, despite the commentary about funding cuts and so on, the colleges' cash reserves have doubled, which is significant and must be acknowledged in the committee. I ask you to clarify the comments that Mr Macintosh made about paragraph 32 on student numbers. A figure of 48,000 fewer people was mentioned and we have heard that 1,200 staff have left the sector. However, your report states that

"colleges continue to meet ... targets for learning activity"

and that the full-time equivalent number of students has

"remained broadly constant at about 120,000 to 125,000".

That tells me that there has obviously been a shift in emphasis from part-time to full-time courses, and that those 48,000 people have not disappeared, because a substantial proportion of them must have converted to full-time courses. Is that the case?

Caroline Gardner: We certainly do not know whether that is the case. The committee might want to explore with the funding council what it knows about the individuals who make up the sheer head count numbers that we have. However, I am happy to restate that what we say on student numbers is a direct reflection of the Government's proper policy choice—it is the Government's role to do that—to focus on younger and full-time students because of the link to employability and the economic priorities. We can see that clearly in exhibit 9, which shows an increase in full-time students against a decrease in part-time students. Exhibit 10 shows that, as you say, the colleges have met their targets for learning activity, which is measured in weighted student units of measurement.

Willie Coffey: How can we lose 1,200 staff from the sector but maintain learning activity at previous levels?

Caroline Gardner: That is a question for the funding council and individual colleges. I suspect that the answer is in part about the merger and reform agenda. Some of it will be about regionalisation and the ability to plan across a region how best to meet learning demand in the area. It is a question for the sector, rather than for us as auditors.

James Dornan (Glasgow Cathcart) (SNP): The report mentions that the number of young people attending college has increased. I have two questions on the opportunities for all scheme. First, do you plan to monitor the outcomes of the scheme—I see that monitoring of outcomes is suggested in the report. Given that there will be more 16 to 24-year-olds going to college, will you monitor the end result, such as whether people go on to university or employment? Do you have any way of monitoring the result?

Caroline Gardner: My answer to that will be similar to my answer to an earlier question.

The first step is on how the funding council and the Government monitor the impact of their policy choices, as they should be doing. That is one of our recommendations. If we decide to do an evaluation of the reform programme as a whole, those are very much the sort of questions that we will explore, along with the question of teaching quality that Ms Scanlon highlighted.

James Dornan: Was there anything previously, or is there anything now, to let us know where students go when they leave college?

Caroline Gardner: Phil Grigor can perhaps help with that.

Phil Grigor: In the new outcome agreements, quality of education covers issues such as retention rates, qualifications achieved and destinations. The improved outcome agreements—they have certainly improved since last year—focus more on delivery of education and where students go as a result of it. We would like them to improve further and become more outcome focused so that there is a greater link-up with the wider education agenda and overall policy.

James Dornan: You also talk about a possible knock-on effect being that people aged 25 and over will have less access to college. The Government made an extra £61 million available in the hope that it would help to mitigate that. Will you be able to monitor that extra money going into the system to see whether it has a positive effect for those who are affected?

Caroline Gardner: Yes. If we carry out an evaluation of the whole reform programme, that is one of the probes that we will use. We expect that the Government and the funding council will monitor the money first—we should review what they are doing rather than monitor it instead of them.

The Convener: Do you have a question, Mary?

Mary Scanlon: No, I have already asked it. It was on the £15 million for the UHI.

The Convener: It has been a long session, which indicates the interest that there is in Scotland's colleges. It has been very useful. As well as giving us an explanation, you have highlighted a number of questions that we may want to pursue with others. That has helped to shape our thinking on where we might want to go. Thank you very much.

"Housing in Scotland"

11:16

The Convener: The next item on the agenda is another section 23 report, "Housing in Scotland". Fraser McKinlay is going to give us a briefing on the report.

Caroline Gardner: I thought that Phil Grigor and I might like a break after the previous session, so Fraser will take over.

Fraser McKinlay (Audit Scotland): Good morning. Housing is important for Scotland's people and communities. Well-planned, good-quality housing contributes to strong, resilient communities and supports economic growth. It is a national asset and an area of significant public investment.

The Scottish Government has an ambitious vision to provide an affordable home for all by 2020. The environment in which the housing sector operates is not straightforward, and this is the first time that Audit Scotland has looked in depth at the housing sector as a whole. In this audit, which is a joint report by the Auditor General and the Accounts Commission, we have considered how Scotland's housing sector works, how much money is spent and what that money delivers. We have taken a wide look at the whole sector and we will consider, in the future, whether we should look in more depth at some of the issues that have been raised by this work. We will obviously be interested in the committee's views on that.

We are not suggesting that there is a magic bullet that will solve the nation's housing needs in one go. The strength of the economy and wider financial pressures have a considerable impact on the housing sector. The recession and constraints on lending have meant that the number of new houses that have been built by the private sector, the number of first-time buyers and the number of mortgages that have been approved have all more than halved. At the same time, public sector budgets have reduced, with the Scottish Government's housing budget falling by around a third in real terms between 2008-09 and 2011-12.

There are significant pressures on council and registered social landlord finances, in particular their capital budgets. Subsidies for RSLs have reduced at the same time as national targets on quality, energy efficiency and fuel poverty are placing increased demands on resources. Members will be aware that, since we published our report, the Scottish Government has increased its subsidy for new homes by £16,000 per unit, following an assessment of the financial capacity of councils and RSLs.

At the moment, there is no easy option for funding housing. The economic climate has meant that more innovative sources of funding have had to be sought. In response to the pressure on resources, the Scottish Government is encouraging councils and RSLs to use alternative models of finance to lever private investment into housing. Those potential new sources of funding, such as bonds and pension funds, bring new risks and complexities that must be properly understood. To date, the use of those models has been limited and the extent to which they can compensate for the reduced levels of subsidy is not yet clear. Many councils and RSLs lack experience and expertise in alternative financing models, which is why we think that the Scottish Government should clarify the role that it expects those sources of financing to play in the future, and help councils and RSLs to understand how best to take advantage of them and minimise the risks involved.

We would also like to see greater clarity in financial reporting. You will see, from the report, that the funding for housing is an extremely complicated mixture of public and private finance, with one-off capital payments and on-going revenue funding from several different sources. That can make funding streams hard to track and can cause difficulties for those who are planning and delivering housing.

Good housing can make a positive contribution to improving a wide range of outcomes for communities, including economic growth, community safety and improved health. However, housing's contribution to those wider aims could be improved. Local planning arrangements are complicated, and effective leadership is required at national and local levels to ensure that housing makes the biggest contribution that it can make to the achievement of better outcomes.

I will pause there. I and my colleagues—Claire Sweeney and Sally Thompson, who were the team on the project—will be happy to answer your questions.

The Convener: Thank you. You say that the local planning situation is complicated and, from reading the report, I gather that the funding arrangements are hugely complicated. It is difficult to get a clear idea of what is happening in order to make comparisons.

Exhibit 6 on page 17 of your report shows the target for affordable homes that was set in 2011. What is the definition of "affordable home"?

Fraser McKinlay: I will ask the team to respond in a second. In the report, we make the point that there is a need for greater clarity in some definitions, and the definition of "affordable home" is one of them. There has been a real change in the past decade in how we view housing and the state's role in housing. We have gone from a quite narrow definition of social housing to a much wider interest in affordable homes and helping people to get on the property ladder in the private sector. Claire Sweeney or Sally Thompson may be able to comment specifically on the definition of "affordable home".

Sally Thompson (Audit Scotland): As our report says, the terms "affordable homes" and "social homes" have previously been used interchangeably. "Social homes" generally means traditional council and RSL homes for rent at significantly reduced levels. "Affordable homes" adds to that the idea of mid-market rents, meaning that someone still rents their home at a reduced level but may be able to buy it in the future.

The Convener: Your understanding is that the definition of "affordable home" is purely about homes for rent.

Sally Thompson: It is also about homes to buy in the future. That is what the target is about.

The Convener: Leaving the future aside, your understanding is that the affordable homes that are being built are only homes that are initially for rent.

Claire Sweeney (Audit Scotland): The final bullet point at the top of page 12 makes the point:

> "Home ownership remains unaffordable for many people"

in Scotland.

> "A property is classed as affordable if it costs no more than 3.5 times a person's annual salary. We estimate that the average property in Scotland costs six times the average salary."

We have highlighted in the report that there is an issue about affordability.

The Convener: So, an affordable home could be a house that is available to purchase.

Sally Thompson: In terms of the Government's target, "affordable homes" means homes to rent in the long term and homes that people rent initially and can then buy.

The Convener: I am not following this. I know that people can have shared equity in their homes and can then purchase more equity in the future. Is the Government's definition of an affordable home one that is currently rented even though it will be available for purchase in the future, or does it include a home that is available for purchase at no more than 3.5 times a person's annual salary?

Sally Thompson: The Government is measuring progress against the target using all houses that are delivered through its affordable housing supply programme. That includes all council and RSL homes, all mid-market homes that people rent initially and may be able to buy, plus all shared-equity-type homes.

The Convener: Okay, but that does not include low-cost homes that are available for outright purchase and which are no more than 3.5 times the person's annual salary.

Sally Thompson: No, it does not include homes that are not being delivered through one of the Government's schemes.

The Convener: So, there has to be a rental component.

Claire Sweeney: As part of that.

The Convener: Does there have to be a rental component for the home to be classified as affordable?

Sally Thompson: No, there does not necessarily have to be a rental component. There are shared equity schemes.

The Convener: Shared equity schemes involve a rental contribution as well as a purchase element. I presume that, if a person buys 50 per cent of the equity, they will pay the capital sum of 50 per cent and pay a rent or the equivalent of a rent on the other 50 per cent.

Fraser McKinlay: This conversation shows exactly why we need a bit more clarity around the definition. As the note on exhibit 6 says—you have pointed this out—we recognise that the numbers are slightly different, depending on where they are taken from. As Sally Thompson said, for the particular target, the number is

"the number of homes delivered through the Affordable Housing Supply Programme."

Sally Thompson has described those. Those numbers will be different from those in the new housing supply statistics. We can certainly try to clarify matters as best as we can, but this might be one of the things that you will want to pick up with the Scottish Government if you correspond with it.

The Convener: How do you assess whether the Scottish Government has met its target when you cannot define what the target is?

Fraser McKinlay: We can define the target, as it is described in exhibit 6. Sally Thompson has just described that.

The Convener: Right. That takes me back to my question. Does every affordable home need to have a rental component?

Fraser McKinlay: I feel that we are getting hung up on the technicalities of what is and is not a rental component.

The Convener: Well, no. How can we have a sensible discussion if we cannot understand what the target is? I understand that any house that is purely for rent would be classified as an affordable home in the social rented sector, and I think that you are suggesting that houses that have a shared equity element and which might have a rental component as well as a capital component are affordable homes, but houses that are available for outright purchase are not classified as affordable homes.

Caroline Gardner: We need to come at the matter from the other end. We know how the Scottish Government measures affordable homes.

The Convener: How?

Caroline Gardner: As we said in the footnote to exhibit 6, and as Sally Thompson has said, they are

"homes delivered through the Affordable Housing Supply Programme."

That is how the Scottish Government has said it will measure progress. At the moment, that includes the various types of homes that Sally Thompson has outlined. There is no reason why the affordable housing supply programme could not include other types of housing tenure in the future, but we think that clarity around the definition would make it easier to understand how well the target sits against need and how well things are being delivered over time.

The Convener: You also say in that note:

"These numbers differ from those recorded in the Scottish Government's New Housing Supply statistics."

It is as clear as mud.

Caroline Gardner: As Fraser McKinlay has said, that is why we think that more clarity around the definition is needed. In narrow terms, the answer to your question is that the target involves

"counting the number of homes delivered through the Affordable Housing Supply Programme."

The Convener: Okay. You mentioned that the target was set in 2011. What was the previous target?

Fraser McKinlay: I will ask the team to come in on that. We are not aware that there was a specific target relating to that, but we will double-check that for you.

The Convener: Was not a commitment made in 2007 on social rented housing?

Claire Sweeney: We have looked at the particular affordable homes target and the background to how some of the thinking was established for it. In the report, we referred to the research that was carried out on behalf of the Scottish Government in 2005, which looked at how many affordable homes it was estimated needed to be built at that point across Scotland. We have not reported on any of the other targets in the report. We could come back to the committee on whether there is any other information underlying that; we looked at the particular target.

The Convener: I might be wrong, but I thought that, originally, a target was set in about 2007 for homes for social renting and then, in 2011, it changed to socially affordable housing with a different, complex, obscure definition. However, you are not aware of what was previously said about aspirations on social rented housing.

11:30

Claire Sweeney: We did not consider that as part of the report.

Bob Doris: I will seek further clarity. I do not want to get hung up on this because I want to ask other questions, but my understanding is that affordable homes will be defined as whatever the Scottish Government decides to spend its affordable homes investment budget on.

Caroline Gardner: Yes.

Bob Doris: There is a serious note to this. I do not seek to state the obvious, but what is an affordable home to one person might not be an affordable home to someone else because people are at a variety of income levels. That is an important point. The issue is monitoring how the Scottish Government uses the budget to make homes more affordable for people.

I think that the convener said that there was a disconnect between affordable homes and new homes. Does the affordable homes budget all go into new-build homes or does it go elsewhere? I want to ensure that we are examining the same thing. When we talk about affordable homes, are we talking about new-build completions that the Scottish Government helps to subsidise, or are we talking about a wider range of investments in affordable housing?

Sally Thompson: Your first point—that affordability varies depending on income and house prices—we raise in the report. There is quite a variation in rent levels throughout the country. Reduced subsidies and tightening budgets will have an impact on rent levels. The report calls for greater clarity in future about what an affordable rent level is, because affordability is not defined in relation to rent.

The affordable housing budget is wider than just new builds because it includes properties that can be bought under the shared equity schemes.

Bob Doris: That is helpful. We cannot make a direct comparison between new-build social housing and the extent to which the Scottish Government has extended affordable housing in the country. They are clearly two separate things.

I will ask a question about housing association grant funding, but it will not be based on the report because it is complex and impenetrable in some respects.

I was a member of the Local Government and Communities Committee in the previous session of the Parliament before I moved on to other committees in this session. There was always a debate with the social housing sector about the level of HAG needed to make social housing affordable and provide the sector with a business model to build new-start social housing.

With a 36 per cent cut in the Scottish Government’s capital budget from the UK Government, there was clearly always going to be less money to spend on new-build social housing. As your report says, some of that clearly fed through to the level of funding for new-build social housing. The Scottish Government reduced the average level of subsidy but, although it is nowhere near the initial levels of subsidy, it has recently increased it again by £16,000.

Do you have any comments to make on how the Scottish Government used evidence on the barriers to new build in the social housing sector, to which it responded by increasing HAG by £16,000? I caveat that question by saying that, on one level, the less of a subsidy per unit we give the social housing sector, the more social housing completions we get and the more affordable houses there are within the sector, so I am always keen for the HAG moneys to be as low as possible, to be frank, because we get more completions out of it. Was the £16,000 increase an evidence-led approach to increasing the subsidy in the social rented sector?

Fraser McKinlay: My caveat is that we did not cover the HAG increase in the report, because it happened after we had done the work. The picture is fast moving and we keep up as best we can.

We looked at the levels of resourcing and funding that are available to RSLs and councils for new build. I think that a working group was set up to look at the issue over the spring, which resulted in a recommendation to the Scottish Government. That, in turn, resulted in the additional £16,000 per unit subsidy.

That is the broad picture, Mr Doris; the team might want to say a wee bit more.

Claire Sweeney: Fraser McKinlay is right: a working group was established and its report fed back to the Scottish Government that an increase was needed. The working group also highlighted the need for consistency over a longer period in that regard, which was interesting.

The report echoed the concerns of the Scottish Housing Regulator about the pressures on the housing sector in Scotland and the need for changes to be made to the resources that are available for housing, if targets are to be met. That was a particular concern, and the Government reacted to the report, which is why the subsidy was increased.

Bob Doris: That is reassuring. Although I want HAG levels to be as low as possible, it is important to get the appropriate balance, to enable development in the social rented sector to continue appropriately. It seems from what you have said that the Government responded on the basis of the auditable numbers from the sector.

I wish that I could ask more questions, but I found the report hard to penetrate with a view to asking focused questions.

Tavish Scott: I will come to the defence of Audit Scotland and the Accounts Commission. I think that the report is admirably clear. It has identified how unclear things are, which is hardly the fault of Audit Scotland or the Accounts Commission.

Bob Doris asked a very interesting question. Mr McKinlay, I take your point about not having considered the issue in depth, but did you find regional variations in Scotland? As Mary Scanlon and I know, the situations in Colonsay and Glasgow are very different—I would not begin to make a judgment about housing costs in Glasgow. Did you find that the one-size-fits-all approach, or a £40,000 or £56,000 subsidy per house, does not help housing associations, which face different pressures in different parts of Scotland?

Fraser McKinlay: I ask Claire Sweeney to respond.

Claire Sweeney: Yes, the issue came up in a few aspects of our work. Another issue that was raised was the planning arrangements and how money is allocated across Scotland.

I should make it clear that the work is not an audit of what is happening across each area in Scotland. However, the different pressures in different areas came through quite strongly. We tried to highlight a couple of examples in the report, to bring the issue to life. For example, we talked about the tensions in Aberdeen in the context of job creation and the link between housing and the local economy.

The challenge that we make in that regard is to ask to what extent the use of public resources is being mapped, so that resources go where they are most needed and are relative to local circumstances. That is an important point.

Tavish Scott: That is helpful.

Exhibit 9 on page 24 shows that there are—if I have added them up correctly—25 separate funding streams. Why did you not recommend simplification of what must be a pretty complex picture even for the cleverest housing professionals in Scotland?

Fraser McKinlay: There is no doubt that the picture is complex, as exhibit 9 and a couple of other exhibits demonstrate. The housing sector told us that this was the first time that anyone had tried to get it on a single page—and that was not a straightforward task.

If such a recommendation does not come through clearly enough, we will reflect on that, Mr Scott. There is definitely something in the report about making the situation more understandable. As I said, there is no easy option or silver bullet that will fix everything. It is about leadership and the Scottish Government being clearer about the funding streams and, in particular, the new funding models, which are not new in themselves but are new to the housing sector.

A community-based housing association that has 200 houses and wants to build more will struggle to get its head around the funding streams—as will some of the bigger housing associations and councils, for that matter. There is an issue to do with capacity building for housing associations and councils, to help them to understand the complex landscape. Simplification would be a good thing, if there are opportunities in that regard.

Tavish Scott: Paragraph 38 of the report describes, in your language, the fact that some schemes are “not always evaluated” but are then changed. Surely that would be a failure of the public pound. Did you assess why those schemes were changed?

Fraser McKinlay: I will ask Claire Sweeney to give more detail on this. The point is that we just do not know whether the schemes were good, bad or indifferent, because the Government did not evaluate them, and the world then moved on. There is a question around how the Scottish Government and councils are ensuring that we are getting absolutely the biggest bang for our buck out of the spend on social housing, in all its complexity.

Tavish Scott: Do you know how many schemes were, to use the language of paragraph 38, not evaluated and then changed?

Claire Sweeney: That is a common thread throughout a lot of what we considered in the report. There are two additional points to mention. One is the need for more consistency and stability over time. Housing is a significant national asset that requires long-term investment, so it is not something that can be dealt with on a short-term basis. There are other exhibits in the report that show money coming in throughout the year. There is an attempt to put money, where it is available, into the housing sector, which is a good thing. That is fine, but we are arguing that a sustained, clear and transparent plan over a length of time is required to enable the housing sector to deal with the priorities that it faces.

Tavish Scott: Would you be so good as to furnish the committee with the number of schemes that changed and were not evaluated over the period of your inquiry?

Fraser McKinlay: We will certainly look into that.

Tavish Scott: Thank you.

In the last sentence of paragraph 38 of the report, you state:

> "Preparing bids can be time-consuming and costly, particularly for smaller organisations."

In your view, will that very fair point be taken into account in the development of the new financial models? In the work that you do with the Government, will you recommend that in simplifying the structure—I cannot urge that enough—instead of coming up with 27 more funding streams, the Government should work that down to an easily digestible number and should be very conscious of the small organisations that have to bid for those funding streams?

Fraser McKinlay: Yes. That would be a really important part of the process from now on. The point about the newer models of funding is not so much about the complexity in the number of different funding sources; it is about understanding the complexity in terms of risk and what the smaller organisations in particular are taking on in going through the process.

Colin Keir (Edinburgh Western) (SNP): My questions are basically about the welfare reform that is currently taking place. You have made a couple of comments in paragraphs 54 and 55 of the report; there is also a comment somewhere that says that rent rises need to be considered.

Is there anything aside from what you have written in paragraphs 54 and 55 that we need to dig into and on which we need to get information? What you have said about the subject is a bit limited. Welfare reform is having a pretty drastic effect right now, and it is important to consider how that effect might carry on in the longer term.

Fraser McKinlay: The short answer to your question on whether there is more to be said is yes—there almost certainly is more to be said.

As I have said, the report represents the first time that we have tried to take an overview of the housing sector, and we have not gone into depth on the impact of welfare reform. That is partly because it is quite new, and the picture is still emerging. In a different part of our work, we have undertaken a survey of councils and their preparedness for welfare reform. There is no doubt that every council in the land has welfare reform in general as one of its top one or two risks—in particular, the spare room subsidy policy and the impact that it will have on rent arrears and other things. That is before we even get into some longer-term issues around what it means for councils' housing stock and the different nature of houses that might be required in future.

We could examine the impact of welfare reform on housing in more detail—we may do so in the future—but you are right to say that we have not done so much of that in the report before you today.

Colin Keir: I will leave the next question that I was going to ask.

11:45

The Convener: I will follow up on that point. You spoke about the implications for local authorities of the bedroom tax, or bedroom subsidy, as you call it. That is right and many councils will feel a lot of financial pressure, but they are better able to cope with that than many of the small housing associations are.

Have you considered what the consequences could be for those housing associations? They are more exposed to bank borrowing than to borrowing from other sources. If they cannot keep up their repayments because of reductions in income, they potentially face going out of business in a way that a local authority would not. They could be open to takeovers from larger housing organisations from elsewhere in the country. Has there been any study of what welfare reform might mean for the housing association sector?

Fraser McKinlay: I will ask the team to come in on this question, but that is the core work of our colleagues in the Scottish Housing Regulator. The SHR is acutely aware of the problem, which has been its main priority for the past couple of years. It is considering the potential impact on housing associations, particularly some of the smaller ones.

The business model for housing associations has had a sound basis for a long time. Welfare reform introduces a significant change to that basis. For some of the smaller ones in particular, the margins are very tight. It does not take much of a reduction in rent or an increase in rent arrears for there to be a pretty fundamental impact on the business model for some small associations. Colleagues in the SHR are acutely aware of the problem and have done some work on it.

Claire Sweeney: That is right. We spoke to some housing associations as part of the audit. That was far and away the biggest risk that they mentioned to us at the outset. It was a consistent concern for them. We have worked closely with the SHR to produce this report. Many of its recent reports highlight the pressures on housing regulators in relation to welfare reform, and it keeps a close eye on this risk. It is a big concern for some of the smaller housing associations.

The Convener: Might you look into the financial implications for the associations?

Fraser McKinlay: It is more likely that the regulator would do that specific work. The SHR has responsibility for oversight of the housing association sector. We do not audit the RSLs directly. We can do whole-systems work, but our colleagues in the SHR would do the work on individual housing associations.

Willie Coffey: I know that a couple of housing associations in my constituency already report a drop in demand for some of the properties with a high number of bedrooms. It is clear that this drop will affect their rental income revenue stream. They also appear to be trying to take some steps—I am not sure whether reconfigure or redesignate is the word to use—to alter the number of bedrooms in a house to overcome this daft UK policy. It would be a useful piece of work to study the impact of that change in the medium to long term on stock levels for housing associations, and how they deal with the situation. It seems to be quite serious.

The report refers to the expected increase in the number of single-person households over the next 20 years. All of that is worthy of further work in the context of policy.

The Convener: I know that Audit Scotland's remit is slightly different, but I wonder whether there might be some opportunity for joint activity with the regulator in which the regulator specifically examines the housing aspect and you consider the financial implications. Increased financial problems that result in housing associations going out of business would have huge financial repercussions. It might be useful to see whether a joint report could be done.

Fraser McKinlay: We can approach that in several ways. As we think about what else we might do on the back of this report, we will work very closely with colleagues in the SHR to decide what to do next and then potentially to work with them.

We have already done some work on welfare reform in our prospective forward programme. We have still to decide how best to get into that big subject, but it is clearly such a significant issue and risk for the public sector that it is already on our radar for future reports.

Colin Beattie: I was looking at page 37, and at paragraphs 79, 80 and 81. Paragraph 81 in particular contains a fairly alarming figure for councils'

"spend on management, repairs and investment and their lost income through empty properties",

which are the things that councils manage. It says that

"council income will be £1.9 billion less than is needed to cover the costs of existing stock",

whereas RSLs will have an excess of £3.9 billion.

Do councils have robust enough systems to be able to make those projections on their own? The projections obviously inform the way in which they handle their investment in their properties.

Claire Sweeney: We undertook that work to see whether there were any issues that we could draw out by comparing how the two parts of the sector operate. We took estimates and used some indicative figures to draw that out. We did not look at local services in great detail as part of the report, but we drew on published information to give an indication of how well RSLs and councils are managing their housing stock, so that we could think about what the financial implications might be over the longer term.

We thought that it was a useful approach to give an indication of any issues arising and any lessons that could be learned between the two sectors. We have shared the information with the Scottish Housing Regulator, which was interested in the methodology, and we are thinking about lessons for the RSL and local authority sectors going forward.

The report shows projections over 30 years and looks at all things being equal, although we know that there are big differences between the RSL and local authority sectors. In essence, the biggest differences are that council rental income is generally lower and that councils tend to spend more on reactive repairs than RSLs do. Councils generally have longer void terms—empty properties. There is also geographical variation across the whole of Scotland for both councils and RSLs.

The work is just an indication, but we thought that it was a useful start to get into looking at some of the issues and comparing the RSL and council sectors.

Colin Beattie: You mention higher subsidies, but you also say that

"the financial relationship between the income and expenditure ... is directly comparable."

Claire Sweeney: In that passage, we were trying to get at the extent to which there is longer-time financial planning for housing. We have highlighted housing in the report as a significant national asset that needs to be invested in, and we were interested in drawing out whether people are taking a longer-term view of the houses.

It is also interesting to consider the role of the Scottish Housing Regulator with regard to the health and strength of the RSL sector. We thought that there are probably some things that could be learned between the two. The report was just a start, to get into that agenda. We did not look at services at a local level, but we tried to draw out whether there are any lessons to be learned.

Colin Beattie: Earlier, we talked about the financial threat to smaller RSLs, but your report seems to indicate that, overall, the RSL sector is fairly robust.

Fraser McKinlay: It depends on the timeframe that you are looking at.

Colin Beattie: Over 30 years, and it is comparable.

Fraser McKinlay: Indeed, and on that basis, as Claire Sweeney tried to describe, there are interesting differences in how the sectors manage their stock. I think that there are lessons to be learned about ensuring that there is investment now and that the stock is well maintained and will remain in good condition into the future. In paragraph 82, we highlight the fact that the Scottish social housing charter includes the issue of how RSLs and councils manage their stock, and colleagues in the SHR will be doing a report on that next year, which will give us a good sense of how they are progressing. Again, we can continue to keep an eye on that within the housing sector to see how different providers are managing their stock.

Colin Beattie: I realise that you have put a lot of estimates into the report, but you say that the figures for RSLs and for councils are comparable. Do councils have the tools to do those projections themselves? You say that there will be a £1.9 billion shortfall over 30 years, which is not a small sum. Presumably, that is £1.9 billion in current funding. What are you going to do with that?

Claire Sweeney: We have shared the methodology, which is on our website. More detail underlies the figures. Anyone could run the projection, because the figures were drawn from publicly available information. There is a model that others can use to get into the figures.

It is worth mentioning the difference in the scale of RSLs. Some are very big organisations and some are very small and local. That is another tension that came through clearly when we carried out our work. Some of the local and small RSLs are focused on community capacity building and regeneration issues in the community. The financial climate presents a risk for those smaller RSLs in dealing with welfare reform and other issues that have been talked about.

We are interested in what the RSL sector will look like, given the financial pressures. The range of organisations needs to be thought about and we refer to that in the report.

Colin Beattie: Have you considered making the calculation of the projections part of the audit of councils, which would give them information, comfort or whatever?

Fraser McKinlay: I am conscious that it feels as if I am not answering your question properly, but I am struggling to understand why. Councils routinely get external advice and expertise on the value of stock and what needs to be spent on it. If that is part of your question, I do not think that we have any concern about the process that councils go through to ascertain those numbers.

Colin Beattie: My concern is that the report tells us that there will be a deficit in council income—councils will make a loss on their housing, which they will have to absorb. How do we feed that into council processes? It is clear that whatever they are doing now is not throwing that up; otherwise, they would react to it. How do we get the information into council processes so that they can react to it? They have 30 years to fix the situation—the crisis will not hit tomorrow.

Fraser McKinlay: As with all our joint reports for the Auditor General and the Accounts Commission, we have engaged with the Convention of Scottish Local Authorities. As part of that exercise, COSLA was involved in the advisory group. Local government has had input and is aware of what is in the report. The issue will be part of the follow-up work that we routinely do for our impact reporting.

It is not necessarily the case that councils do not get it. The reality is that they must make difficult decisions about how they spend their money year to year. Even if they recognise the number, making progress against it is a difficult question, given the competing challenges on their resources.

Claire Sweeney: Local authority colleagues with whom we engaged as part of the work were very interested in what lay beyond the figure and some of the issues that it threw up. One such issue is rent levels across Scotland, which we touched on in the report. That is part of the mix, which includes not just other financial flaws in the housing system but local decisions on rent policies and how they work.

A lot of factors need to be taken into account. However, people have received the messages. The Scottish Housing Regulator understands the methodology that we used and some of the tensions that lie in that. The issue is of interest and we will keep an eye on it, particularly in relation to the report's impact and where it goes next.

Mary Scanlon: I thank Colin Beattie for taking one of my questions; that reduces my time, which is fine.

You tell us at the top of page 29 that something is not clear, and I am not sure whether my questioning will make it clearer, but I feel that I should raise the issue. The report says:

> "The Scottish Government is promoting alternative models of finance, but these carry risks and the extent to which they can compensate for reduced levels of subsidy is not clear".

You tell us that that is not clear, but I am asking for a bit more clarity, which seems to be a contradiction in terms.

I have heard about the subject in the chamber often. From the answers that I have heard, I thought that the Government was confident about how it was proceeding with such funding. What you say causes me considerable concern. If the position is not clear to Audit Scotland, how clear is it to councils and RSLs? Can you help?

Fraser McKinlay: I will do my best.

Mary Scanlon: I am also concerned about the risks.

12:00

Fraser McKinlay: Sure. Our point is that, first, there is a gap between the amount of housing that we need and the number of houses that are being built. The attempt to fill the gap is being made in a very difficult financial climate for housing. I think that the Scottish Government is right to look at different ways of trying to fill the gap, hence the alternative funding model. We are not criticising the use of such a model in any way, because the Government must try to find a way of plugging the gap. I guess that what we are saying is that it is just too early to say. We do not yet have enough evidence to say whether the take-up of the alternative models of finance will be sufficient to plug the gap and to make good the reduced level of subsidy, even with the increase that was announced recently.

That is why we said that the situation is not clear, although we may have more evidence in a year or two that would allow us to say more. Our recommendation is that, given that the Scottish Government has said that alternative models of finance are a potential solution for plugging the gap, greater support and leadership is required on its part to help councils and RSLs get to grips with those alternative models, take them up and start using them. There is a big capacity-building question for all housing associations and councils—particularly the smaller ones—in trying to understand matters such as the bond market, which I do not even begin to pretend to understand. It is therefore important that the social housing sector is helped along that road, if it is seen to be part of the solution.

Mary Scanlon: My second question is on leadership. Lack of leadership is a constant theme throughout the report. On "Planning and management" in part 3, you again say that there is a lack of leadership. You also said in your opening comments that there is a lack of leadership.

You just explained why the situation is not clear, but you did not clearly explain the risks. Obviously, you have information that has led you to highlight in the report that the Scottish Government's

> "alternative models of finance ... carry risks".

Where is the leadership not coming from? Further, where should the leadership be coming from? Tavish Scott and Bob Doris have talked about the complexities of the report, which is a bit of a muddle. Who should be leading? My second point is about the risks.

Fraser McKinlay: I will start on the leadership question and the team can come in on the more specific points around the risks. The leadership question has a number of levels. We have tried to be reasonably specific in the report where we think the Scottish Government has a role around leadership. For example, one role would be around the alternative models of finance that we have spoken about.

Mary Scanlon: So, housing ministers should be leading. Is that what you are saying? Is there a lack of leadership from the ministerial level?

Fraser McKinlay: As I said, I think that we have been quite specific in the report that there is a job for stronger leadership from the Scottish Government around helping councils and RSLs understand and use alternative models of finance more effectively. We make a point later in the report about the extent to which housing is playing its full part in, and is well connected to, other policies, which I think is partly a Scottish Government issue and partly a local issue. We have done community planning work recently in three places in Scotland and found that housing was not plugged into the community planning framework locally strongly enough or at a sufficiently strategic level. When we talk about stronger local and national leadership later in the report, that is the kind of thing that we are getting at. It is about being much clearer about the role that housing can play in improving health and wellbeing, the economy and so on.

Mary Scanlon: The recommendations on page 30 make the point that the Scottish Government should provide leadership.

Fraser McKinlay: Yes.

Mary Scanlon: Perhaps I missed this, but what about the risks? What are the risks?

Fraser McKinlay: The team will come on to those now.

Claire Sweeney: The risks are largely financial. As we say in the report, the environment is challenging anyway and the approach that has been taken is one option. That is not to say that there are not risks with taking other approaches, but there are clearly financial risks around some of the newer alternative models of financing. Those risks change over time and depend on a range of different factors. Different financial mechanisms can be used, each of which has its own set of risks and challenges.

Some common risks relate to the stock, to the possible financial impact from underwriting guarantees if those go wrong and to the potential effects on the market. A raft of different issues need to be taken into account, depending on which model is pursued, such as the effect on rental income, the condition of stock and existing loans and covenants. All those things need to be taken into account before determining whether something is a viable option.

Lessons can be learned from elsewhere—from other parts of the public sector, from England and from overseas. Lessons can be learned from where things went wrong or did not work out, but there is certainly an appetite for that. Other bits of the public sector are more familiar with some of those issues, which may be new for housing.

Mary Scanlon: At paragraph 59, the report states:

"Many councils and RSLs lack experience and expertise in alternative financing models."

Coupled with that are the risks that you mentioned. Obviously, that is where the leadership is needed.

My final question is on exhibit 7, which is on page 21. Why is there £9 million more announced funding than there is in reality? How could the Government announce £9 million more than is actually available?

Claire Sweeney: This probably comes back to the message about the confusion over whether bits of funding have been announced previously or as part of another package. It was quite a challenge just to get to this point to articulate the changes to the funding arrangements over time. The report tries to set out what the top-line figures were at different points in time. Exhibit 7 tries to illuminate all the changes that have happened over time within that two-year period.

Mary Scanlon: So the figure that I have referred to may not be accurate. The amount involved is not huge, but it is still significant.

Fraser McKinlay: The two columns in exhibit 7 relate to two different years—I hope that I have understood your point correctly—and cover the announcements from 2012-13 and then the 2013-14 affordable housing supply budget line. I made this point slightly flippantly earlier, but the team had to spend a lot of time trying to get underneath this stuff. It was incredibly difficult to produce the exhibit on page 21—

Mary Scanlon: I can understand that.

Fraser McKinlay: The reason that we make the point about announcements is that an awful lot of the information comes through announcements in Parliament and other places. We had to spend a long time piecing together the information. However, you ask a very good question.

Mary Scanlon: I just wondered how the announcements balanced with the actuality.

Ken Macintosh: I want to ask about the report's rather worrying conclusion that we will not meet housing demand over the next 20 years. How will that reveal itself? Will there be more kids living with their parents? I ask because I have six kids, so that is a frightening prospect.

Willie Coffey: You need a couple of extra huts.

Ken Macintosh: Yes, the sheds are going up in the garden as we speak.

More seriously, does that mean that people will be living in unsuitable accommodation? Will the problem be reflected in longer waiting lists than already exist?

Fraser McKinlay: I will ask the team to respond to that, Mr Macintosh. I have only three kids, so perhaps I will not be in quite as bad a shape as you.

It is difficult to tell, but there may well be a combination of all the things that you have mentioned. In this section of the report, we have tried to hold up a mirror to the Scottish Government and to the public sector by taking the research that was done back in 2005. The evidence suggests that there is a real gap

We have tried to map the trend on best-case, average-case and worst-case scenarios. Over that time period, many things can change, but the signs are that we will not have enough houses unless we do something quite different to meet need, in terms of overall numbers and of the shifting demographic and its implications for the housing stock.

I am not sure that I can answer your question about what that will mean, but I think that it might well involve a combination of the things that you mentioned.

Ken Macintosh: The current recession is clearly having an impact, but you seem to be suggesting that a different approach is needed. In other words, you are saying that, rather than being related to a particular recession, the problem is structural; it is an on-going issue that will not go away if the economy picks up. Is that right?

Fraser McKinlay: It is absolutely clear that what has happened in the economy since 2007-08 has made it much more difficult to make progress. To be fair, the Scottish Government has responded to that by introducing new initiatives and different ways of generating more house building on the supply side. The financing that we have mentioned is one example of that.

I do not know whether any of the team would like to add to that.

Claire Sweeney: As we highlighted in the report, there are still shortfalls with the information that we have. For example, issues have been raised such as people living alone or living longer. We do not have sight of information that gives more detail about people with particular disabilities, which might lead to a need for a different type of housing. The ageing population will have an impact. The housing sector in its broadest sense faces a raft of challenges. We tried to emphasise clearly in the report that although there were challenges to do with the recession, the amount of housing stock and how suitable that stock is, it is a challenging time for housing in Scotland.

Ken Macintosh: You measured completions. Did you measure new starts as well?

Sally Thompson: The Scottish Government does that. It keeps a database on starts, completions and approvals.

Ken Macintosh: Did you look at new starts?

Sally Thompson: For the purposes of the report, we focused on completions—the number of houses that were built.

Ken Macintosh: A particularly alarming figure on fuel poverty is given in exhibit 6 on page 17, which says:

> "In 2002, 13 per cent of people were living in fuel poverty. In 2011, 30 per cent of people were living in fuel poverty."

Are you confident that that figure will be reduced, or will it continue to increase?

Claire Sweeney: That is one of many issues in the report on which we could have carried out more work. The report provides an overview of housing in Scotland. We tried to reflect all the different elements of housing policy and the breadth and complexity of the housing sector, so there are a number of issues on which there could well have been greater focus. They include issues to do with homelessness, capacity in the sector, the new-build programme and fuel poverty. We drew out issues that we thought were significant enough to warrant a place in such a report, but there is undoubtedly a big story behind quite a lot of the issues that are raised in the report.

Ken Macintosh: There is a target of abolishing fuel poverty by 2016. Is that even remotely possible?

Fraser McKinlay: I do not think that we are in a position to say whether it is possible at this stage. For me, that is a good example of how housing is central to a bunch of other stuff. The fact that we are heading in the wrong direction on the fuel poverty target is not just to do with housing. A bunch of stuff will be happening that will be contributing to that. That is why we think that the housing element of public policy—particularly when it comes to improving outcomes, reducing inequality and dealing with issues such as fuel poverty—is central and needs to be more central.

Ken Macintosh: Part of that would be retrofitting—trying to improve the energy efficiency of existing older houses. Did you look at that?

Sally Thompson: Yes. As we mention in the report, partly in response to fuel poverty and the targets on energy emissions, the Government is considering increasing energy efficiency standards for homes. There is already an energy efficiency standard that all council and RSL homes have to meet, and the Government is looking at raising that standard to help to address such issues.

12:15

Ken Macintosh: Could you also look at existing older properties in the private sector, which, I would think, would form the majority of Scottish housing?

Sally Thompson: The current standards are just for the social housing sector.

Claire Sweeney: That said, the report highlights issues with regard to the state of private housing stock and its broader implications for the public sector and housing in general. Although we focused on public finance and resources in the public sector, we could not ignore the significant part that the private sector plays and have tried to bring it in where relevant.

Ken Macintosh: Just on—

The Convener: This will be your final question, Ken.

Ken Macintosh: All right, convener.

As far as I am aware, most of the public finances are used to support new build in the private sector and to spark private purchasing of new-build housing, whereas in the rest of the UK they are used to buy older homes as well. Did you look at the effectiveness or uptake of such programmes and whether they represent good value for money?

Claire Sweeney: We did not look at such schemes at that level of detail.

Sally Thompson: The new money that was announced earlier this week includes help for first-time buyers to buy homes and for second-time buyers to move on to new homes. As a result, an element of that money is for older properties.

Ken Macintosh: So some of that is for older properties, is it?

Sally Thompson: My understanding is that a first-time buyer could use the money that way. However, the second-time buyer has to buy a new property.

Ken Macintosh: I had only one more question, convener, but I will let you move on.

The Convener: Okay. We will have a final question from Willie Coffey.

Willie Coffey: Despite the recession, which a few people have mentioned, and despite huge cuts in capital and revenue budgets of up to 29 per cent, we are in a good place as far as house building in Scotland over the past period is concerned and the Scottish Government's achievements over the past few years have been pretty good. My information and research has thrown up three particular figures. I will try to use terminology that I think I understand, convener. In the past six years, 6,000 people or families have been able to buy property under shared equity schemes; 30,000 new houses have been built in terms of the social housing definition; and with regard to council house building, which, as previous housing spokesperson for my group in East Ayrshire, is close to my heart, nearly 4,000 new council houses have been built.

I have always tried to persuade people, particularly in my constituency, to continue to rent, because it is a really attractive option for the future and indeed became more so as the recession bit hard. I therefore do not think it is any surprise that because of the recession the Scottish Government attempted to remodel how some of these—

The Convener: Do you have a question for Audit Scotland?

Willie Coffey: Yes, convener, but it is important to make these points. After all, others have had the chance to make their points.

What worries me more in the long term is whether supply can meet demand. Mr Macintosh referred to that in his questioning and the Auditor General's report mentions that there will be more single-person households over the coming years. I am worried about the long-term planning for that issue, and wonder whether the report could have contained a stronger message to the Scottish Government and other partners to get together to think about this issue more forcefully over the next few years.

I am also worried about the impact of these changes, particularly the benefit changes, on the private rented sector and its ability to meet the Scottish housing quality standard, which, as I understand it, the sector is not required to do at the moment, and I think that there is a good piece of work that either our committee or one of the other subject committees could do on that matter.

Overall, though, performance over the past few years has been pretty good.

The Convener: Stunned silence from everyone.

Mary Scanlon: We were waiting for the question.

Willie Coffey: Well, the question is about looking to the future.

Fraser McKinlay: I absolutely take your point about the long term, Mr Coffey, and we can certainly reflect on how we have worded our recommendations in that respect. When we talk about how the long-term vision underpins national policies and informs local planning and practice and the need for a clearer strategy, that is exactly the kind of thing we are getting at.

I said earlier that a lot of activity and innovative thinking is going on in difficult circumstances. We have spoken about exhibit 6, which shows some things that are good in their own right, but they have come along at a time when money is reducing and it is more difficult to get funding for housing.

It is also worth referring to exhibit 5 in this context. It demonstrates that the structure of housing has changed beyond all recognition since the early 2000s; consider how many council and RSL homes we used to have. The world is very different now and we encourage the Scottish Government, councils, RSLs and others to get around the table and start thrashing out the discussion about the future and how to meet the need.

Willie Coffey: Audit Scotland does not look at the private sector and the standards that we expect of it, but someone should, convener, whether it be us or another committee. That piece of work needs to be done because of the impact of many of the changes that we are seeing just now.

The Convener: Audit Scotland has looked at housing from a specific point of view, and at the Government's targets and budget. Willie Coffey makes a relevant point, because more people are now being pushed towards the private sector, for whatever reason, which means a significant cost to the public purse. Could that fall within Audit Scotland's remit in some future work?

Fraser McKinlay: It is worth bearing it in mind that councils are the strategic housing authority for their local areas and they need to consider the housing system in the round. Exhibit 1 shows that more than three-quarters of housing in the country is in private hands. Interestingly the real change has been in owner-occupied housing rather than in private rented housing, the levels of which have come down since the 1970s.

We cannot work on private housing directly, because our job is about public spending, but in looking at how whole systems work, we would look at how the Scottish Government and councils are reflecting the private sector and the market in shaping what they can do. Even then, we can see real shifts in the past few years in the extent to which the Government is trying to influence, shape and intervene in the private market in a way that it would not have done some years ago, and we have seen some announcements on that recently. The emphasis is clearly already shifting and we will continue to track and monitor the situation as part of our work.

However, to be clear, I do not think that we could go in and do a specific audit of the quality of private sector rented accommodation. That is not within Audit Scotland's remit.

The Convener: I accept that. I know that the Infrastructure and Capital Investment Committee will be looking at the proposed housing bill, which will include a number of issues to do with the private rented sector. I was thinking about the financial implications for the public purse, given the changes in the way in which housing benefit is being managed. I know from my constituency that there has been an increase in the number of people who are in private rented housing and the rents are significantly higher than they are in either the housing association or council sector. That will impact on the housing benefit budget. Perhaps that is something that Audit Scotland should keep its eye on and, if you could make a relevant contribution to the Infrastructure and Capital Investment Committee, I am sure that it would be appreciated.

Thank you for that. Again it just shows the interests and challenges that there are in housing.

"Renewable energy"

12:24

The Convener: The next item on the agenda is a section 23 report on renewable energy. I invite Caroline Gardner to brief the committee.

Caroline Gardner: The Scottish Government estimates that renewable energy could deliver up to £30 billion of investment and 14,000 jobs in Scotland by 2020. In addition, renewable energy could contribute to reducing emissions and providing a more secure energy supply.

The Government wants renewable sources to meet 30 per cent of Scotland's energy use by 2020. Realising the potential of renewable energy is central to the Government's economic strategy and its goal of sustainable economic growth.

Members will be aware that the Economy, Energy and Tourism Committee conducted a wide-ranging inquiry into the renewable energy targets last year. Our report complements that inquiry by examining what the public sector has done to develop renewable energy, what investment it has made and what has been delivered to date. We focused on activity and investment by the Scottish Government, Scottish Enterprise and Highlands and Islands Enterprise. It is worth noting that we did not examine the role of the planning system or the consents process in assessing applications for renewable energy projects.

Overall, we found that the Scottish Government is providing clear leadership, direction and ambition for the development of renewable energy. It has a clear strategy to 2020 that is well linked to other policy areas such as housing and planning and to the strategic priorities of other public bodies. The Government's renewable energy targets demonstrate considerable ambition for the sector, and particularly for renewable electricity, for which the 100 per cent target is much higher than the UK Government's 30 per cent target. The Scottish Government has made steady progress towards its targets, but achieving them will be challenging and will rely on significant activity and investment over the next seven years.

The development of renewable energy relies largely on investment from the private sector. Attracting, encouraging and enabling that investment is the focus of activity and funding by the Scottish Government, Scottish Enterprise and Highlands and Islands Enterprise. For example, the two enterprise agencies have together invested £43 million in specific ports and harbours around Scotland to make them suitable for use by the offshore wind and marine energy industries. Collectively, the Government and the two enterprise agencies spent more than £209 million on delivering renewable energy over the 11 years to March 2013. More than 90 per cent of that—£193 million—was spent in the past six years, since March 2007, and funding is increasing. Exhibit 6 on page 19 of the report illustrates the scale of the increase.

The budgets for the next two years—2013-14 and 2014-15—total £264 million, which is intended to lever in billions of pounds-worth of private sector investment. However, the current financial climate is making potential investors more cautious. Uncertainties about reforms to UK energy policy, the cost and reliability of new technologies and access to the national grid are also delaying investment decisions. Those issues are not exclusive to Scotland, and the Government is working with the UK Government to try to address them. We recommend that the Scottish Government and the two enterprise agencies identify what specific additional steps they can take to accelerate progress, especially in relation to offshore wind.

The uncertainty means that projects that are eligible for public sector funding are not progressing as quickly as anticipated, and public bodies are experiencing delays in spending some of the money that is available to them. When the finance secretary presented his draft budget for 2014-15 to the Parliament last month, he proposed that the £101 million budget for the Scottish Government's renewable energy investment fund should be extended over an extra year to 2015-16 to reflect the lower-than-expected progress.

The report is positive overall, but we make three specific recommendations to build on the progress that has been achieved so far. First, total investment in the Scottish economy by the renewable energy industry is not monitored, although Scottish Enterprise and Highlands and Islands Enterprise individually monitor private sector investment in the projects that they fund. We think that the Scottish Government should collate that information and report at a national level how much the private sector has invested in renewable energy projects that have received public funding.

Secondly, as I mentioned earlier, the Government estimates that renewable energy could deliver up to 40,000 jobs by 2020. However, we found that the assumptions that were used to reach that estimate are based on optimistic scenarios. For example, 28,000 of the estimated 40,000 jobs are in the offshore wind sector, but this assumes that there will be twice as much offshore wind capacity in 2020 than current industry estimates suggest. We therefore recommend that the Scottish Government works with its partners to ensure that revised employment projections, which are due by the end of the year, are realistic.

Finally, I highlight our recommendation that the Scottish Government should set out how it aims to develop renewable energy beyond 2020 and should develop targets to reflect that. That will be important in demonstrating to potential investors the Government's long-term commitment to developing renewable energy.

As ever, convener, we will be happy to try to answer the committee's questions.

12:30

The Convener: I know that it is not Audit Scotland's responsibility to recommend changes in policy, practice or priorities, but given the discussion that we have just had on housing, was any work done to estimate the financial benefit to individual households and, more significantly, to the public purse of implementing a change to housing and planning policy to require new-build properties to have certain minimum standards of insulation and/or solar panels installed?

Caroline Gardner: I ask Mark Roberts to pick up on that, based on what we know about the interrelationship between those two policy areas in the Government.

Mark Roberts (Audit Scotland): In the context of this audit, we did not look at policies to encourage take-up of insulation or the use of solar panels at the individual level. Obviously, those are important in the Government's wider low-carbon strategy but not within the context of this audit or the work of the two enterprise agencies, which was the primary focus.

The Convener: I was not asking about steps to encourage take-up; I was asking whether any consideration was given to the financial benefit to the public purse of investing in higher insulation standards and, perhaps more significantly, solar panels at the new-build stage. For example, rather than encourage individual householders to apply for grants, there might be a requirement for solar panels to be installed as a matter of course in new-build properties. What would be the costs and long-term benefits of that and what is the cost benefit ratio? Is there any value to the management of public finances of doing that at the planning and construction stage rather than have to react and to encourage individual households to do it at a later stage?

Mark Roberts: There is an interesting potential piece of work to look at what the longer-term benefits might be if building standards were changed to require higher insulation standards or renewable energy technologies. However, within this piece of work, we did not do any of those calculations or look at those potential changes, so I could not comment further on that.

Bob Doris: The convener makes an interesting point, because the report is excellent and we are looking at next steps as much as at the content of the report, so that was a fair question.

I will tread delicately with my question. The convener said that we might have an incentive to put solar panels on new-build houses, which might be like reducing VAT to incentivise that kind of thing. I do not want to blur devolved and reserved issues—that is not my reason for asking this question. I have a constituency interest in relation to a company called Gaia Wind, which makes small-scale wind turbines for farmers and individuals. The business model is very much based on UK Government feed-in tariffs to subsidise the turbines and bring them on line. Recent changes in feed-in tariffs mean that those microrenewables will pay for themselves after five years whereas, under the previous regime, it was three years. I will not drag in the details of feed-in tariffs, but in auditing what the Scottish Government is doing to achieve its ambitions on renewable energy, did you do any work on how that interacts with policy decisions elsewhere? I do not want to drag you into constitutional issues, because the question is not about that. It is about how we boost renewables in Scotland.

Caroline Gardner: I take the question in exactly the spirit that is intended. This area is a good example of a complex area that is made more complex by the current mix of devolved and reserved powers. We say in the report that the Scottish Government has ambitious targets that are well linked to its wider policy agenda and that it is doing a lot to make progress on meeting them. We are also clear about the parts of the UK energy policy that can make that harder. The first is to do with access to the national grid and the way in which that works. The second is to do with transmission charges for more remote parts of the UK. Mark Roberts might want to expand on that but, in broad terms, because of the limits of my responsibility in auditing the Scottish Government's expenditure and the Scottish Parliament's budget, we have focused on the existing boundaries of what is devolved while recognising that the issue has to be examined in the context of wider UK policy and wider economic factors, such as the current uncertainty about large financial investments.

Mark Roberts: To pick up on the points about the feed-in tariffs, one of the problems that the sector as a whole faces is uncertainty as to what happens in the future with feed-in tariffs and their potential replacement. That is tied in with the wider issue of the electricity market reform that is taking place at the UK level. As we say in the report, that has had an impact on the pace at which public bodies have been able to spend some of the money that the Government has made available to them because that uncertainty is slowing down the rate at which projects are coming on stream. People are waiting to see what happens and how the energy market reform is resolved before they commit to projects.

Bob Doris: I suspect that the detail of that will be for another committee but, given my constituency interest, I wanted to put some of it on the record.

Mary Scanlon: I want to get a bit more clarity about jobs. My son is a civil engineer and a project manager for wind farms. However, when a wind farm is finished, the job is finished, so I appreciate that it is difficult to get a snapshot.

In March last year, there were just over 11,000 jobs in renewable energy. That included 1,000 jobs in colleges, universities and the public sector, so we are talking about just over 10,000 jobs.

The Auditor General mentioned jobs in her opening statement. Paragraph 74 of the report says that

"the most optimistic scenario of 40,000 jobs"

has been used in forecasts. That is apparently twice as many as the industry is suggesting for offshore jobs. The least optimistic scenario is around 13,000 jobs.

Can we get a little bit of honesty? It will not be 40,000 jobs—it is not 40,000 jobs at the moment. There is a big difference between 13,000 and 40,000—one is three times the other. Are we looking at nearer 13,000 jobs? Is 40,000, in your own words, an "optimistic scenario"?

Caroline Gardner: The 40,000 certainly is an optimistic scenario. That is why I recommend that the revised forecasts that are due by the end of this year should be more realistic.

Three things are going on. First, the current forecasts include a number of scenarios, which is good practice. When we are forecasting, by definition we do not know what will happen, so having and testing different assumptions is a good thing. Using the most optimistic one does not do justice to the complexity of that planning.

Secondly, as we say, there has been a delay in some of the expected investment because of the wider uncertainty about the investment required, much of which it is outside the Government's control and reflects market conditions or UK energy policy.

Thirdly, what is a renewables job is not always clear.

Mary Scanlon: I was just about to come to that. Is it fair to include almost 1,000 jobs in colleges, universities and the public sector? Would those people lose their jobs if we stopped building wind farms?

Caroline Gardner: I ask Mark Roberts to take you through that. He has focused a lot of attention on that question and can give you a better answer than I can.

Mark Roberts: The figure of 11,000 is based on a survey carried out by Scottish Renewables, the organisation that represents the renewables industry in Scotland. It is in the process of trying to revise that figure for 2013, and I expect to see the revised figure in the next few weeks.

As the Auditor General said, it is hard to understand exactly what a renewables job is. It is difficult to define. People who work for engineering consultancies, divers and maintenance crews may well work in the oil and gas industry as well as in marine renewables environments. That is why, when we spoke to the enterprise agencies, they said that it was hard even to get a firm handle on exactly what an energy job—in the widest sense—is, let alone a renewables job, because many of the skills are transferable between sectors.

Mary Scanlon: The temporary nature of the jobs must also be taken into account.

Mark Roberts: We do not have any information on whether they are permanent or temporary roles.

Mary Scanlon: My second question concerns exhibit 7 on page 23, which is on public and private sector investment in ports and harbours. Orkney and Shetland were left out of "Scotland's colleges 2013". I did not want to ask about that when we discussed that report under item 2, but they are also left out of the information in exhibit 7. The Western Isles are mentioned, but not Orkney and Shetland. Have they not been investing in their ports and harbours?

Mark Roberts: The various dots on the map in exhibit 7 show the 11 ports and harbours that were identified in the national renewables infrastructure plan back in 2010. There was one site on Lewis and there were no sites on Orkney and Shetland in that plan, but that is not to say that there has not been investment in ports and harbours on Orkney and Shetland, supported in part by HIE. However, that was outside the scope of the national renewables infrastructure plan.

Mary Scanlon: I am slightly surprised by that, but never mind.

An estimated total of £253 million is needed. I think that the largest investment that is being sought—£36 million—is at Ardersier, which is just outside Inverness. Where will that money come from?

Mark Roberts: It is expected that the vast majority of it will come from private sector investments in building facilities at ports and harbours to allow the development of predominantly offshore wind facilities but also the wider marine technologies and wave and tidal facilities that the Government hopes for.

The six sites for which Scottish Enterprise has responsibility are illustrated with purplish dots on the map. The initial estimates were that they required £164 million-worth of investments to upgrade them to the necessary level. Scottish Enterprise put aside £70 million to try to support that investment, leaving the balance to come from the private sector.

Mary Scanlon: Given that the figure for Hunterston is £65 million, that is quite a significant amount from the private sector.

Mark Roberts: Yes.

Mary Scanlon: Would the amount for the Highlands also be met by the private sector?

Mark Roberts: Yes.

Mary Scanlon: That is quite a significant amount.

Ken Macintosh: The Government and many of the rest of us support greater community ownership of renewables, but that does not seem to have been a phenomenal success so far. There is a section on that on page 20 of the report.

Caroline Gardner: I will ask Mark Roberts to come in with more detail on that. That is one of the issues that we highlight in the report as having been made more difficult by the current economic climate in which people are working. The Government has two schemes: the community and renewable energy scheme—CARES—and the renewable energy investment fund. The schemes are intended to help communities to take advantage of the opportunity to invest in renewables schemes in their areas, if I can put it in that way, but both have been slower to take off than the Government expected. I ask Mark Roberts to talk through why that has been the case.

Mark Roberts: One of the challenges that projects face is their financing. CARES, to which the Auditor General referred, is controlled to a certain extent by European regulations, which broadly specify the interest rates that have to be charged. The rates are relatively high, which reflects the perceived risks of some of the projects. Perhaps communities are less willing to take on those risks and attract the high interest payments. Formerly, many of those projects were financed by grant funding and no risk was associated with them, whereas now community groups and perhaps individuals are finding it harder to take on the risks, as they have to raise money from the market.

Ken Macintosh: You do not seem to have made any recommendations about that. Do you have any recommendations on how community ownership could be improved?

Mark Roberts: We have not made recommendations about that. The Government evaluated CARES fairly recently, and responsibility for the organisation that runs and delivers the scheme has changed. Having taken that on in August this year, it is looking at evaluating whether it can find ways to improve accessibility for community groups, for example. I expect it to report on that in the relatively near future so that we can see what the best way forward might be to address exactly the issue that you have raised.

Ken Macintosh: Do you make an overall assessment of the main beneficiaries of the renewables expansion and who they are? Do you assess who owns the companies that make the turbines and wind farms and who owns the energy that is produced?

12:45

Caroline Gardner: We have not made that analysis so far, as it is not necessary to do so in looking at progress against the Government's targets and the investment that it has made. Those are all relevant considerations in evaluating the wider economic benefit, although we have not looked at them as part of this work. That evaluation would need to take account of the wider constraints that come from global trade obligations and our membership of the European Union.

Ken Macintosh: I have a final question. According to your recommendations, the Government does not appear to have

"a methodology to monitor its target for overall energy demand".

Do you think that that is a gap?

Caroline Gardner: Not necessarily, but I ask Mark Roberts to tell you about that.

Mark Roberts: The overall energy demand target of 30 per cent of energy demand being met from renewable sources by 2020 is made up of the heat, transport and electricity targets. To put it crudely, if you add those three together you will get an indication of the overall energy demand. The Government is working on refining the method behind that, and our recommendation encourages it to ensure that it does that. By chance, because of those three targets, it is currently about a third of the way towards meeting the overall energy demand target.

Willie Coffey: Auditor General, there were three main messages in your summary. One was about monitoring private sector investment and another was on the issue of the 40,000 jobs. I want to focus on the third one: the implications for all of us—for the Scottish Government and the Scottish population—post 2020. My attention is drawn to the chart on page 13 of your report, which contrasts starkly the renewables revolution in Scotland and what is happening in the UK. I draw your attention to the electricity generation circle, which shows that we expect 100 per cent of electricity in Scotland to be generated from renewables by 2020 compared to a UK figure of 30 per cent. Going back to your third message about the situation post 2020, is there an opportunity for Scotland and the Scottish Government to develop the renewables revolution here further to capture some of the UK market and help our neighbours down south to keep their lights on?

Caroline Gardner: I am not sure that I can answer that question directly. The reason why we made our recommendation is that—this is, in some ways, similar to the situation with housing—the up-front investment that is needed is significant and needs to be made over a long period. In any circumstances, but particularly in the current economic climate, it is important that any Government gives potential investors as much certainty as possible about its commitment over a long period of time to a particular policy area and the targets that underpin it.

The question of how we see our energy supply policy and how it links to energy security and economic revenue streams is a wider policy question for the Government that I do not think we are equipped to answer.

The Convener: Willie Coffey asked about sales. Have you looked at how much it costs to generate renewable energy and what the subsidies are?

Caroline Gardner: You will see from our report that that is not a major part of what we have done, but I ask Mark Roberts to talk you through our thinking in that area.

Mark Roberts: The cost of renewable energy is very much dependent on the maturity of the technology. Big efforts are being made to reduce to a certain level the cost per megawatt in, for example, offshore wind. The technology, engineering and infrastructure are not there yet, so electricity that is generated in that way will be more expensive. With technologies that are at an even earlier stage in their development—for example, wave and tidal—the cost per unit of electricity is higher still. Part of the economic prize that is being sought is a reduction in that cost to enable Scotland to market and sell the expertise more widely.

The Convener: Our aspiration to sell on significant amounts of renewable energy by 2020 will depend on how much it costs us to produce it and how much the market is able to sustain.

Mark Roberts: That is absolutely the case, yes.

The Convener: Okay. Thank you for that. It is a very interesting report that throws up a number of challenges for the future.

12:49

Meeting continued in private until 13:25.

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