

# Transport Scotland

Report on the 2006/07 Audit



November 2007





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# Executive Summary

## Introduction

Our audit was based on understanding the key strategic and financial risks being faced by Transport Scotland. We audited the financial statements and aspects of governance and performance management were reviewed by ourselves and colleagues in Audit Scotland. This report sets out the key findings.

## Financial Statements

We have concluded that the financial statements of Transport Scotland give a true and fair view of the state of affairs of the Agency as at 31 March 2007 and of its income and expenditure for the year then ended.

We have also concluded that, in all material respects, the expenditure and receipts shown in the financial statements were incurred or applied in accordance with applicable enactments and relevant guidance issued by Scottish Ministers.

We have also reviewed the other issues which we are required to consider as part of our audit opinion such as the management commentary, the remuneration report and the statement on internal control. We can confirm that there are no matters arising in relation to our responsibilities in these areas that we need to bring to attention.

Significant matters arising from the audit of the financial statements are commented on in the relevant section of this report. In line with our normal practice, we will record our detailed audit findings, which will also cover less significant matters, in separate letters or reports to management.

## Financial Position

Transport Scotland's operating costs for the year were £1,756 million; income totalled £0.7 million. At 31 March 2007, the Agency had net assets of £13,216 million, reflecting Scotland's trunk roads network.

Following agreement with the Scottish Government, Transport Scotland incurred a planned overspend of their resource budget of £5.6 million (£20.7 million, excluding the effect of the notional cost of capital).

## Performance

Two reviews by Audit Scotland were reported in the period. In September 2006 the Auditor General published an overview of the performance of transport in Scotland. In June 2007 the Auditor General published a review of the proposed tram and rail projects for Edinburgh. Summary information on these reviews is included in the body of the report. Transport Scotland's financial statements commented on the latter review as a post balance sheet event.



Transport Scotland's annual report records satisfactory progress against most corporate and business plan targets.

## **Governance**

We conducted a preliminary review and evaluation of the governance arrangements relating to Transport Scotland as at April 2007. We considered the overall framework within which Transport Scotland operates, which is influenced to a significant extent by being an executive agency of the Scottish Government, and confirmed that the expected arrangements had been put in place. In relation to its internal structures and processes, we found that Transport Scotland had made significant progress towards establishing appropriate corporate governance arrangements and that there was scope to further develop and embed these arrangements in line with good practice.

## **Looking forward**

Audit Scotland has been appointed as the external auditor of Transport Scotland for the 5-year period to 2010-11. During this period, we will continue to fulfil our responsibilities in accordance with the appointment and with the Code of Audit Practice. As part of the 2007-08 audit we will follow up relevant matters arising from the 2006-07 audit work and build on our understanding of controls and systems by carrying out further reviews. It is likely that Audit Scotland and Transport Scotland will need to work collaboratively in response to issues such as the faster closing agenda; Best Value self assessment; the Efficient Government Initiative; and the implications for Transport Scotland of the adoption of International Financial Reporting Standards from 2008-09. Audit Scotland colleagues in Public Reporting Group are planning to undertake studies of major capital projects and rail franchise arrangements, both of which will impact on Transport Scotland.

**Audit Scotland  
November 2007**



# Introduction

1. This report summarises the findings from our 2006-07 audit of Transport Scotland. The scope of the audit was set out in our Audit Plan, which was presented to the Audit Committee on 19 March 2007. The plan set out the key business priorities and the risks facing the organisation in not achieving these; and described the work we planned to carry out on the financial statements, performance and governance. The key business priorities and risks identified related to:
  - the efficient, effective and economic management of Scotland's rail and trunk road networks
  - the establishment and running of national concessionary travel schemes
  - the delivery of the Scottish Government's committed programme of enhancements to the rail and trunk road infrastructure
  - Transport Scotland assisting in building Scotland's National Transport Strategy by recommending and advising on investment priorities for tomorrow's rail and trunk road networks; and,
  - Transport Scotland striving towards excellence by building their working principles (expressed in terms of human resource management, financial management, Best Value and communications) into everything they deliver and into how they work as an organisation.
2. The key risks relating to the audit of the financial statements included:
  - preparation and timing of the first set of statutory accounts
  - complex accounting arrangements for valuation of the roads network
  - accounting for PFI/PPP, including establishing a protocol for considering potential new schemes
  - the broader control environment in relation to concessionary fares expenditure.
3. Significant matters arising from the audit of the financial statements and other work by Audit Scotland are commented on in the relevant section of this report. Performance audit reports by the Auditor General for Scotland are published separately and available from Audit Scotland's website. Also, in line with our normal practice, we will record our detailed audit findings, which will also cover less significant matters, in separate letters or reports to management.
4. This is the first year of a five year audit appointment. We would like to take this opportunity to express our appreciation for the assistance and co-operation provided by the officers of Transport Scotland during the course of our audit. This report will be submitted to the Auditor General for Scotland and will be published on our website, [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk).



# Financial Statements

5. In this section, we summarise key outcomes from our audit of Transport Scotland's financial statements for 2006-07, and comment on the key financial management and accounting issues faced.

## Our responsibilities

6. We audit the financial statements and give an opinion on:
  - whether they give a true and fair view of the financial position of Transport Scotland and its expenditure and income for the period in question
  - whether they were prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements, and
  - in all material respects, the expenditure and receipts are regular (comply with statutes and guidance).
7. We also review the statement on internal control by:
  - considering the adequacy of the process put in place by the Chief Executive as Accountable Officer to obtain assurances on systems of internal control, and
  - assessing whether disclosures in the statement are consistent with our knowledge of Transport Scotland.

## Overall conclusion

8. In relation to these responsibilities we have given an **unqualified** opinion on the financial statements of Transport Scotland for 2006-07.

## Financial Position

### 2006-07 outturn

9. Transport Scotland's operating costs for the year were £1,756 million, with income of £0.7 million. 2006-07 was the first full year for Transport Scotland and, given its new responsibilities and the changing scale of activity for some existing operations, it was decided that it would be inappropriate to construct pro-forma, prior year comparative figures.



10. Programme costs accounted for 99% of expenditure, with £757 million spent on motorways and trunk roads activities, £650 million on rail services in Scotland, £162 million on concessionary fares schemes, and £174 million on major rail projects. The nature of the Agency's role is such that only £14.2 million (1%) of its budget was used on its ongoing running costs. Almost all of the budget was spent, either directly or indirectly, with private sector companies engaged in major transport infrastructure projects, related maintenance or operational aspects of transport activity.
11. Income from rent of land and property in the year amounted to £0.7 million.
12. Following agreement with the Scottish Government, Transport Scotland incurred a planned overspend of their resource budget of £5.6 million (£20.7 million, excluding the effect of the notional cost of capital) – see exhibit 1 below.

**Exhibit 1 – Performance against Resource Budget 2006-07 (£000)**

<b>Resource Allocation (£000)</b>	<b>Budget</b>	<b>Actual Outturn</b>	<b>Difference</b>
Operating Costs	815,355	796,205	19,150
Investment	476,844	500,115	(23,271)
Capital	142,000	158,645	(16,645)
Sub-total	1,434,199	1,454,965	(20,766)
Cost of Capital (notional)	475,000	459,860	15,140
<b>Total</b>	<b>1,909,199</b>	<b>1,914,825</b>	<b>(5,626)</b>

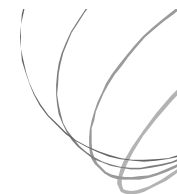
## **Financial position at 31 March 2007**

13. At 31 March 2007, Transport Scotland held net assets of £13,216 million (a 5.6% increase from the £12,519 million of the previous year). This largely reflected Scotland's trunk roads network, which had a net book value of £13,072 million at the balance sheet date (a 4.7% increase from the previous year's £12,483 million). The significant factor in the movement was indexation by application of Baxter indices published by the Office for National Statistics. (Movement in the Baxter index was 5.0%.)

## **2007-08 budget**

14. The budget for 2007-08 has been set at £2,038 million by the Scottish Ministers. This includes £518 million to cover notional cost of capital, leaving an operating budget of £1,520 million, and is an increase of £129 million (6.8%) on the previous year's budget. The budget breakdown is as at Exhibit 2 below:





### Exhibit 2 – 2007-08 Budget (Scotland) (No 4) Bill prior to Autumn revision

2007-08 budget	£000	change from 06/07
Resource – Operating Costs	818,611	+0.4%
Resource - Investment	576,355	+20.9%
Capital	125,800	-12.9%
<b>Sub-total</b>	<b>1,520,766</b>	<b>+6.0%</b>
Cost of Capital (notional)	517,750	+9.0%
<b>Total Operating Plan</b>	<b>2,038,516</b>	<b>+6.8%</b>

15. The most significant allocations within the resource budget are £628 million for rail infrastructure and the rail services franchise, £192 million towards concessionary fares schemes, £272 million for major public transport projects, and £251 million towards motorways and trunk roads (mainly maintenance, repairs and improvements). The resource budget also includes £14.5 million to cover Agency administration costs. The capital and cost of capital budgets relate to motorways and trunk roads.
16. The largest single component in the budget movement is a £83 million (79%) increase in the concessionary fares budget as uptake increases in its second full year.

## Issues arising from the audit of the financial statements

17. International Standard on Auditing (ISA) 260 requires auditors to report certain matters arising from the audit of the financial statements to 'those charged with governance' prior to the accounts being signed. We reported in the terms of ISA 260 to the audit committee in July 2007. The key issues arising on the financial statement are recorded below.

## Preparation of the accounts

18. Transport Scotland's financial statements capture complex underlying activity, systems and accounting arrangements. This complexity, the relatively early timetable and the "first time" factor have provided a challenge to both Transport Scotland in preparing the accounts, and to Audit Scotland in auditing them. Transport Scotland maintained an "unders and overs" schedule which tracked the accuracy of estimates made in the preparation of the accounts and recorded mis-statements which were identified during the audit. This is a good starting point in identifying areas for improvement in the accounts preparation and audit processes.
19. Parliamentary accountability arrangements require disclosure of information on contingent liabilities beyond that required by Financial Reporting Standards. This aspect of the accounts was addressed fairly late in the process and disclosures in relation to rail arrangements were identified as being



potentially detailed and involved. While disclosures in 2006-07 were acceptable, it was recognised that this issue should receive more prompt and detailed attention in 2007-08.

**See action plan point 1: Accounts preparation**

## **Accounting policies**

20. Transport Scotland “inherited” accounting policies from previous arrangements within the Scottish Government. Consistency over time is an important feature of the application of accounting policies. Also, for Transport Scotland, there are constraints in terms of ensuring consistency with Scottish Government group accounting policies and, in the context of the roads network, with UK policies. However, following this first year of experience of preparing their own accounts, there may be scope for considering whether the practical implementation of policies should be adapted to reflect Transport Scotland’s circumstances. (It is noted there are two important factors to be taken into account in the evaluation of any change in accounting policy and its timing: Parliamentary approval of budgets and reporting of outturn should be on a consistent basis; and International Financial Reporting Standards will be introduced for financial statements for 2008-09, which may change some accounting policies significantly.)
21. **“Section 70” grants** – the policy in this area is to try and capture underlying activity. For the Edinburgh Trams project this resulted in a large accrual at the year end, because estimates of work completed were not crystallised by way of post year end invoices in a timely manner. In such circumstances, the policy of accounting on the basis of underlying activity is difficult for Transport Scotland to manage and for Audit Scotland to audit. Therefore, there is merit in considering the implementation of this policy: whether in practical terms it can be improved, or whether a better balance can be struck between the principle involved and the practicality of its implementation, so that a reliable and consistent approach can be applied year on year.
22. **Compensation for compulsory purchase of land** – For joint projects the accounting policy applied has been to capitalise the net cost of land under fixed assets, with the provision relating to the estimated compensation similarly shown net. However, there has been some confusion in the accounting entries for this over the period, resulting in an overstatement of both provisions and cost of land. An alternative policy would be to capitalise the full cost of land and show the contribution from the third party as income. This policy would simplify the accounting thereby reducing the potential for confusion. The existing and alternative policies should be considered in light of current circumstances to determine which is the most appropriate going forward.
23. **Accounting adjustments relating to the roads network** – Current practice is that the Operating Cost Statement is charged with any shortfall between cost of construction and valuation when a new element of road is brought on to the road network. Other adjustments identified in relation to the dimensions/ route of the roads network (for example, from more accurate measurement) are matched



by equal and opposite entries direct to the General Fund in the balance sheet, rather than the Operating Cost Statement. This is because these other adjustments clarify the value of the roads network taken on to the balance sheet at the inception of resource accounts. This has been and remains the correct policy for most situations. However, if the other adjustments clarify the measurement or value of additions to the network after 2002-03 (the introduction of resource budgeting) it may be appropriate for them to be accounted for in the Operating Cost Statement. Transport Scotland should remain alert to this possibility and consider what steps they may need to take to ensure that they can identify any relevant adjustments.

**See action plan point 2: Accounting policies**

## Statement on Internal Control

24. The Statement on Internal Control provided by Transport Scotland's Accountable Officer reflected the main findings from both external and internal audit work. The statement recorded management's responsibility for maintaining a sound system of internal control and set out the Agency's approach. The statement noted the issues arising from the Internal Audit review of the Older and Disabled Persons National Concessionary Fares Scheme; and that the Accountable Officer had established a cross-functional Control Review Project Team, firstly to undertake a review of the control assurance environment and initial weaknesses identified, and, secondly, to implement recommendations for improvement. The Project team provided the Accountable Officer with detailed documentation of the control and process environment that was in place for the year under review; and is working with Concessionary Fare Scheme staff to implement the review's recommendations:
- to formalise risk profiling and modelling to focus inspection and surveying activity; and,
  - to improve reporting on concessionary fares activity to senior management.
25. The Accountable Officer has also set objectives for the Executive Board within Transport Scotland to undertake a regular review process to ensure that improvement to the assurance and control environment within Transport Scotland is monitored closely.

**See action plan point 4: Concessionary fares**



# Performance

26. The audit of the public sector is more wide-ranging than that of the private sector and covers the examination of, and reporting on, performance and value for money issues. As part of our audit we are required to plan reviews of aspects of the arrangements to manage performance, as they relate to economy, efficiency and effectiveness in the use of resources.
27. Accountable officers also have a duty to ensure the resources of their organisation are used economically, efficiently and effectively. These arrangements were extended in April 2002 to include a duty to ensure 'best value' in the use of resources.

## Reports by the Auditor General for Scotland

28. Two reports were published by the Auditor General for Scotland during the period of the 2006-07 audit that related to Transport Scotland's responsibilities.

### **Scottish Executive: an overview of the performance of transport in Scotland**

29. The above report was published by the Auditor General in September 2006, and was the first of its kind to look at an area of Scottish Government policy in the round. As such, it was intended to contribute towards the development of public performance reporting and to inform thinking about future strategy. While the report is concerned with functions that were served by the Scottish Government, responsibility for many of these has now passed to Transport Scotland.
30. The report highlighted that the Scottish Government had performed well against most of its transport targets, but that more should be done to provide a full picture of what is being achieved with the investment, which is expected to rise to £2.3 billion in 2007/08. The Auditor General noted that *there is a huge challenge ahead in developing a transport network that balances support for economic growth against the need for a sustainable transport system that minimises impact on the environment.*

### **Edinburgh transport projects review**

31. A study was carried out by Audit Scotland, on behalf of the Auditor General, to consider the arrangements for managing the delivery of the Edinburgh trams and Edinburgh Airport Rail Link (EARL) projects. This followed a request by the Cabinet Secretary for Finance and Sustainable Growth on 4 June 2007. It should be noted, however, that the study did not review the operating costs or projected revenues of the projects, either of which could have a significant impact on each project's financial operation.



32. A report setting out the key findings of this study was published and laid in Parliament on 20 June 2007. It highlighted, in respect of the Edinburgh trams project that *arrangements in place to manage the project include a clear corporate governance structure, well defined project management and organisation, sound financial management and reporting, good risk management procedures, and a procurement strategy aimed at minimising risk and delivering successful project outcomes.*
33. However, with regard to the EARL project, the report noted that the project was unlikely to be completed by the target date of the end of 2011, and that the *lack of agreement over governance arrangements and a procurement strategy is inhibiting progress. In practice, this means that a number of key decisions still need to be made before there can be more certainty about the cost and time targets, so there is currently a higher degree of uncertainty about the EARL project than might be expected.*
34. The Transport Scotland financial statements disclose the following as a post balance sheet event: *“After the Scottish parliamentary elections on 3 May 2007, a new Administration was formed. Incoming Ministers asked for a review of projects within the Transport Scotland portfolio, together with a specific review by the Auditor General for Scotland of the costs and management of the Edinburgh tram scheme and the Edinburgh Airport Rail Link scheme (EARL). The outcome of these reviews was debated in Parliament on 27 June 2007. As a consequence, work on EARL was suspended to allow alternative means of providing a link between Edinburgh Airport and the rail network to be examined and for there to be further consideration of the governance arrangement of EARL.”*

## Progress against targets

35. Transport Scotland’s Corporate Plan 2006-08 and Business Plan 2006-07 sets out 5 high-level aims, each supported by a set of objectives and targets or milestones. The Annual Report for 2006-07 records progress against each target in terms of ‘achieved’, ‘ongoing’, or ‘not achieved’. Most of the targets which were planned to be achieved in 2006-07 were achieved. For those with longer time horizons progress has been assessed as ‘ongoing’, which is satisfactory in the circumstances. A brief summary and commentary by aim/ business priority is provided below.



**Exhibit 3 – Summary progress against 2006-07 targets by business aim**

Business aim	Commentary on achievement of targets
The efficient, effective and economic management of Scotland's rail and trunk road networks	Most targets are long term and progress is recorded as satisfactory/ 'ongoing'. The annual target to increase rail passenger numbers by 2% was achieved.
The establishment and running of national concessionary travel schemes	Annual targets for establishing the 2 schemes for older & disabled persons and young people were achieved. Progress on wide availability was assessed as satisfactory/ 'ongoing'.
The delivery of the Scottish Government's committed programme of enhancements to the rail and trunk road infrastructure	6 out of 7 annual targets were achieved, covering legislative processes, commencement of work, etc. The target not met was the opening of the Stirling-Alloa-Kincardine railway. Satisfactory progress recorded in relation to other project milestones.
Transport Scotland assisting in building Scotland's National Transport Strategy by recommending and advising on investment priorities for tomorrow's rail and trunk road networks	3 out of 4 targets were achieved or 'ongoing'. Delivery of the High Level Output Specification for Network Rail did not meet the April 2007 target (but did meet the statutory deadline).
Transport Scotland striving towards excellence by building their working principles (expressed in terms of human resource management, financial management, Best Value and communications) into everything they deliver and into how they work as an organisation	4 out of 5 targets were achieved or 'ongoing'. The target of establishing a quality management regime based on Annual Business Reviews was not achieved.

## Best Value

36. As recorded in the governance section, work by internal and external audit during 2006-07 provides some positive assurance on arrangements to secure continuous improvement. However, no specific review of Best Value or Best Value characteristics was carried out as part of the 2006-07 audit. It is likely that as part of the 2007-08 audit we will be reviewing the progress that Transport Scotland has made in strengthening their arrangements for securing Best Value. Over the next year, we will also be developing and refining our approach to the audit of public bodies' arrangements to secure economy, efficiency and effectiveness in the use of resources, as this is one of our key objectives as auditors, set out within the new Code of Audit Practice approved by the Auditor General. This will inform our ongoing work to develop an approach to the audit of Best Value across the Scottish public sector. We intend to consult with both clients and stakeholders at key stages of these initiatives.



# Governance

37. This section sets out our main findings arising in relation to Transport Scotland's governance arrangements. Below we comment on:

- our overview of governance arrangements
- systems of internal control
- internal audit, and
- aspects of information and communications technology (ICT).

## Overview of governance arrangements

38. We conducted a preliminary review and evaluation of the governance arrangements relating to Transport Scotland as at April 2007. This covered both the overall framework within which Transport Scotland operates and its internal arrangements.

## Overall governance framework

39. The overall framework within which Transport Scotland operates is influenced to a significant extent by being an executive agency of the Scottish Government. Our review confirmed that the expected arrangements had been put in place.

40. The main issue arising from the evaluation of the overall framework is the recognition that, as the responsibility for different aspects of Transport is split between the Scottish Government and Transport Scotland, this increases the importance of clear communication and co-ordination between Transport Scotland and the Scottish Government. While recognising this is an area of subjective judgement, the work of internal and external audit to date confirms that overall liaison and communications appears to be working well in both directions; there have been no specific instances identified in which the arrangements have not worked satisfactorily. So far there has been a degree of continuity in staffing in this area and staff at both Transport Scotland and the Scottish Government will have a mutual understanding of their respective roles. However, TS and the Scottish Government recognise the need for both parties to keep the position under review. As the position evolves (as staff move on, etc), there may be a need to consider having "refresher" events or more formal arrangements to maintain effective working arrangements.

## Transport Scotland arrangements

41. Our review recognised that Transport Scotland is a relatively new organisation, which is actively developing aspects of its governance arrangements. In relation to its internal structures and



processes, we found that significant progress had been made towards establishing appropriate corporate governance arrangements and that there was scope to further develop and embed these arrangements in line with good practice.

42. Significant progress was evidenced in that Transport Scotland had:

- established relevant Board and Committee structures and built on consultation and appraisal arrangements in order to meet strategic business needs
- established appropriate corporate and business planning processes, with performance management arrangements that facilitate the cascading of organisational aims to personal objectives
- appropriate resource allocation arrangements, covering budget setting, monitoring and forecasting that identify both potential savings and overruns
- further developed risk management arrangements carried forward from the Scottish Government processes, including the board reviewing the most significant, corporate risks at monthly board meetings
- further developed arrangements to manage continuing operations in road, rail and in relation to major projects
- developed, or were developing, arrangements for their new responsibilities in relation to rail and concessionary fares
- developed guidance covering internal procedures as required, while rolling forward Scottish Government guidance where appropriate (including those relating to the prevention and detection of fraud)
- established internal audit arrangements that built on the previous regime
- established organisational values by promoting five “**working principles**” and adopting and promoting the Scottish Government’s commitment to **Equalities** and **Environmental considerations**
- put in place appropriate arrangements covering propriety, codes of conduct, etc
- developed plans to produce an annual report and annual accounts, reporting on performance and financial outturn.

43. There is scope to further develop arrangements in line with good practice in the following areas:

- the arrangements for induction, training and development of Board members in relation to their role and responsibilities as members of the Board, including clarifying/ formalising the guidance/ arrangements applicable to non-executive board members





- to build on the first year's experience of corporate planning
- to build on the arrangements established in relation to concessionary fares
- in relation to finance (and to a lesser extent IT) posts that are embedded in operational divisions: Transport Scotland should evaluate the respective benefits of centralised versus devolved arrangements in these areas, bearing in mind the importance of consistency of practices and clarity in reporting lines and accountabilities
- in relation to operational arrangements adopted from the Scottish Government: Transport Scotland should, over time and as capacity allows, reflect on their experience of working with the common systems and procedures of the Scottish Government group with a view to identifying:
  - areas in which the economies of scale and other factors mean that Transport Scotland will work with Scottish Government systems, although it may need to tailor procedures to make arrangements effective (for example, in other agencies, this will apply to main finance, payroll and HR systems)
  - areas in which there is more scope for Transport Scotland to develop their own arrangements (for example, other agencies have developed more of their own HR arrangements and Transport Scotland plan to do so)
  - on guidance and documenting of procedures: Transport Scotland should tailor these to its own circumstances as appropriate.

**See action plan point 3: Corporate governance arrangements**

## Systems of internal control

### Concessionary fares

44. An internal audit of Concessionary Fares arrangements provided limited assurance, as it concluded that inaccurate operator claims could not be adequately mitigated by existing controls. Internal audit also noted concerns over card-issuing procedures, highlighting inconsistency in local authority practice and lack of audit trail over validation of eligibility. In response, Transport Scotland undertook a review of arrangements and implemented the recommendations of the review through the Concessionary Fares Scheme Controls Review Project in period the April to July 2007.
45. Given these circumstances, we carefully considered whether there was sufficient evidence that the operator claims under the Concessionary Fares Schemes represented reimbursement for eligible journeys by eligible passengers. Our assessment included a thorough review of the additional evidence on the control environment, analysis of movements in levels of claims from the previous regional and local concessionary fares regimes, and a review of progress made by the controls review project. Overall, we concluded that there was sufficient evidence to provide a clear audit opinion, in



relation to both the regularity of expenditure and the “true and fair” view; and that disclosures in the Statement on Internal Control were appropriate. We also note the importance of following through on the recommendations of the Controls Review Project.

**See action plan point 4: Concessionary fares**

## **Scottish Government central systems**

46. As indicated in the review of governance arrangements, Transport Scotland use Scottish Government central systems. As auditors we rely on colleagues auditing Scottish Government systems to provide assurance that central systems and related key controls and procedures are operating satisfactorily in the following areas:

- internal audit arrangements;
- the operation of the main accounting system (SEAS);
- accounts payable systems (including the operation of Easebuy);
- the central aspects of the accounts receivable system, and cash and banking systems (including the reconciliation of the main bank account);
- the central aspects of the operation of the Britannia fixed asset system;
- the central aspects of the operation of the payroll and subsistence systems.

47. We obtained the expected assurances, but there are matters to note in relation to payroll and VAT.

48. As anticipated the central systems audit team concluded that there continue to be weaknesses in the operation of the shared payroll system (for example, central checking that starters to and leavers from the payroll system are being processed as intended). We planned for and performed additional work to provide assurance in this area; and took assurance from Transport Scotland’s work on payroll costs and charging.

49. Transport Scotland’s accounts record a VAT debtor of £8 million, representing their share of the Scottish Government’s VAT debtor. Assurances on VAT figures from Scottish Government systems were received, but later than anticipated in Transport Scotland’s timetable.

**See action plan point 5: Scottish Government central systems**

## **Internal Audit**

50. The establishment and operation of an effective internal audit function forms a key element of effective governance and stewardship. We therefore seek to rely on the work of internal audit wherever possible and, as part of our risk assessment and planning process for the 2006-07 audit, we



assessed whether we could place reliance on Transport Scotland's internal audit function, which was provided by the Scottish Government's Audit Services division.

51. Colleagues auditing central systems and arrangements confirmed that overall the Scottish Government's Audit Services division operates in accordance with the Government Internal Audit Standards and that we should plan to rely on their work. Our own review of their files confirmed this position in relation to the following reviews:
- Concessionary Fares
  - Management of the ScotRail Franchise
  - Funding of Network Rail
  - Corporate Governance.
52. The outcome of the Concessionary Fares review has been covered elsewhere in this report. Internal audit provided positive assurance in relation to their other reviews and we relied on their work as a major source of assurance in these areas. For the ScotRail franchise and Network Rail we were able to limit our work mainly to tying in the annual accounts figures. On corporate governance, because of our respective responsibilities both internal and external audit produced reports, but we shared plans and findings to minimize any duplication of effort.

## Information and Communication Technology

53. As part of our risk-based assessment, carried out during the initial planning stage of the audit, we identified Information and Communication technology as a priority area for review in 2006-07. The following sections summarise the ICT reports that we issued to management as part of our 2006-07 audit programme.

### Computer Services Review

54. Transport Scotland management were asked to complete a Computer Services Review Client Questionnaire (CSR-CQ) and our findings are based on a review of documentation provided and interviews with staff. The CSR-CQ provides a high-level, risk-based assessment of ICT services.
55. Transport Scotland are on the Scots network, which is a fully managed and supported network service provided by Information Systems and Information Services Division (ISIS) within the Scottish Government. In summary, the respective responsibilities for IT are as follows:
- The Scottish Government is responsible for the Scots network and Government Secure Intranet (GSI) connectivity



- Agencies are responsible for their own business application servers and systems in respect of confidentiality, integrity and availability.
56. As Transport Scotland was only launched, with a new corporate ICT department, in January 2006, some ICT policies and arrangements are still being developed and implemented. Our overall assessment is that the Agency has made progress towards the provision of ICT arrangements and has implemented areas of good practice, particularly in:
- introducing an ICT steering group who undertake a dual role covering all aspects of ICT and Governance
  - installing good access and environmental controls in the server rooms
  - monitoring contracts and service level agreements with key service providers
  - providing adequate and up-to-date detection and prevention controls to protect against viruses and other malicious software.
57. We also identified a number of areas in which improvements could be incorporated into operational practice, in particular by:
- having a formally-agreed corporate ICT strategy
  - providing clearly-defined roles, responsibilities, and accountability for all aspects of ICT
  - adopting a corporate standard for the provision of ICT and also formally documenting policies for all business application systems
  - ensuring that all business areas know the level of ICT service they should receive, and centrally monitoring that each area receives an appropriate level of service
  - maintaining an accurate and up-to-date inventory of hardware and software, and establishing and documenting the existence and ownership of information assets used in running the business
  - developing business continuity plans and disaster recovery plans to ensure service continuity in the event of a serious incident.
58. An action plan detailing risk areas and planned management actions has been agreed with management.

**See action plan point 6: Information & communications technology**

## **Your Business @ Risk**

59. During the year we facilitated a comparative self assessment of the business risks associated with information and communication technology; the survey comprised two sets of questionnaires: one for



ICT users and one for ICT staff; the comparators were other UK public sector organisations. The findings identified areas of good practice/ good levels of staff knowledge and awareness, such as

- password security regarding logging on to networks/computers and automatic time out after a short period of inactivity;
- knowing that they will be monitored in their internet and email use through awareness of the user acceptance policy and that mis-use may be treated as a disciplinary offence; and
- knowing where to obtain help regarding computer problems and advice on handling sensitive information.

60. However there were a number of ICT governance areas for which the survey suggested a lower level of knowledge or awareness:

- information security management including policy, guidance and key responsibilities;
- anti-fraud strategy and procedures;
- business continuity management protocols;
- responsibilities under the Data Protection Act, Freedom of Information Act; and general awareness of other legislation i.e. Computer Misuse Act, Human Rights Act, Public Interest Disclosure act; and
- understanding the threats from and actions to take regarding IT virus attacks.

61. It is perhaps worth emphasising that that the findings of the survey should not be taken as indicating that the relevant controls are not in place, but rather that there are areas in which awareness levels could be improved. Studies have re-enforced the importance of staff knowledge and awareness in ensuring the effective operation of policies and procedures. At the time of the survey, the Head of IT indicated the intention to update the relevant aspects of guidance together with action to increase awareness of issues. As part of the audit for 2007-08 we would seek to follow up Transport Scotland's responses to the survey.

**See action plan point 6: Information & communications technology**



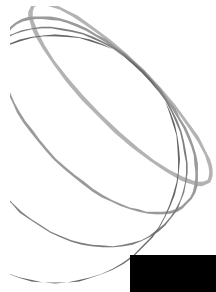
# Looking Forward

62. Audit Scotland has been appointed as the external auditor of Transport Scotland for the 5-year period to 2010-11. During this period, we will continue to fulfil our responsibilities in accordance with the appointment and with the Code of Audit Practice. As part of the 2007-08 audit we will follow up relevant matters arising from the 2006-07 audit work and build on our understanding of controls and systems by carrying out further reviews. For example, on **Concessionary Fares**, we will monitor the development of the scheme, including progress on rolling out SMART enabled processes and the role of the National Entitlement Card as part of this; we will also monitor progress on implementing the recommendations of the Control Project Review Group
63. In addition it is likely that Audit Scotland and Transport Scotland will need to work collaboratively in response to issues such as the faster closing agenda; the implications of for Transport Scotland of the adoption of International Financial Reporting Standards from 2008-09; Best Value self assessment; and the Efficient Government Initiative. Issues raised earlier in this report in relation to preparation of accounts and accounting policies, together with new developments, will be relevant to the first two items. We will discuss options on the latter two with Transport Scotland. For example, at other organisations we have facilitated a self assessment of Best Value arrangements. On the Efficient Government Initiative, Audit Scotland carried out work as part of 2005-06 audits with a view to following up in 2007-08; we will follow up the previous audit work at the Scottish Executive/ Government as relevant to Transport Scotland.
64. Also, Audit Scotland colleagues in Public Reporting Group are planning to undertake studies of major capital projects and rail franchise arrangements, both of which will impact on Transport Scotland. The main aim of the **major capital projects** study is to provide a position statement on how recently completed and current major capital projects managed and sponsored by the Scottish Executive/ Government performed against time, cost and quality targets; and whether current projects are being managed using good practice to achieve project objectives, based on a review of a sample of projects. The study will build on and develop the issues and methods in the June 2007 report "*Edinburgh Transport Projects Review*". It will provide a broader picture of performance across all major capital projects, but inevitably Transport projects will be well represented. The fieldwork for the study is underway and the planned publication of the report is in the Spring of 2008. The proposed rail franchise study is at an early stage, with colleagues planning to determine the scope of the study in October/ November 2007.

# Appendix A: Action Plan

## Key Issues and Planned Management Action

Action Point	Issue Identified	Planned Action	Responsible Officer	Target Date
1	<p><b>Preparation of accounts</b></p> <p>Transport Scotland should review the outcome of the 2006-07 process and consider areas for improvement to the accounts preparation for 2007-08. The related audit arrangements should also be reviewed in conjunction with Audit Scotland. This will support the development of an improved timetable for the preparation and audit of the 2007-08 financial statements.</p>	<p>This process has already begun with a 06/07 review meeting held with Audit Scotland on 30/08/07.</p> <p>The timetable for 07/08 will be finalised in January.</p> <p>There will be continued meetings with the Audit Scotland in the run up to the year end as appropriate.</p>	Guy Houston – Director of Finance & Corporate Services	July 2008
2	<p><b>Accounting policies</b></p> <p>Transport Scotland should review the practical implementation of key accounting policies in the light of the experience of the first year of independently applying the accounting policies and the backdrop of developments in financial reporting and associated budgeting rules. Any proposed developments should be discussed with finance colleagues in the Scottish Government and Audit Scotland as appropriate.</p>	<p>We will review the implementation of the policies highlighted in the context of the introduction of International Accounting Standards, which are the next potentially large scale change to existing accounting policies. The Scottish Government have a working party (with Transport Scotland representation) looking at all aspects apart from roads accounting, where there is a more detailed examination taking place using a joint working party covering the 4 home territories.</p>	Guy Houston – Director of Finance & Corporate Services	March 2008
3	<p><b>Corporate governance arrangements</b></p> <p>Audit Scotland's review of corporate governance arrangements confirmed that Transport Scotland had made good progress in establishing appropriate arrangements, but that there was scope to further develop and embed these arrangements in line with best practice and there were aspects that should be kept under review.</p>	<p>The Audit Scotland report contains an action list for areas requiring further development. This will be reviewed quarterly along with similar audits and reviews from Audit Scotland and Internal Audit.</p>	Guy Houston – Director of Finance & Corporate Services	Ongoing quarterly



Action Point	Issue Identified	Planned Action	Responsible Officer	Target Date
4	<p><b>Concessionary fares</b></p> <p>We note that Transport Scotland are committed to the implementation of the recommendations from Controls Review Project, through the transition to a SMART-card enabled scheme, with the aim of having external validation arrangements applying the same principles as those of the Performance Audit Group arrangements in relation to road network maintenance contracts. Audit Scotland welcome these developments and will continue to monitor progress.</p> <p><b>Scottish Government central systems</b></p>	<p>Transport Scotland has developed an operational strategy and implementation plan providing comprehensive controls and processes around the Concessionary Fares Scheme. Good progress is being made on this implementation. Control continues to be a high priority and is being monitored closely by the head of the Concessionary Fares Department.</p>	<p>Gordon Hanning – Head of Concessionary Fares</p>	<p>Feb 2008</p>
5	<p>Satisfactory assurances were obtained on the operation of Scottish Government central systems except in relation to payroll and VAT. Transport Scotland should liaise with Scottish Government colleagues on these issues and, if still necessary, review Transport Scotland checks to see whether they can provide a clearer mitigation for any potential shortfall in assurance on the operation or timing of central arrangements.</p>	<p>Transport Scotland have limited control over centrally operated systems but have implemented checks where possible. The Director of Finance &amp; Corporate Services will report these findings to the Scottish Government Finance Director.</p>	<p>Guy Houston – Director of Finance &amp; Corporate Services</p>	<p>Dec 2007</p>
6	<p><b>Information &amp; communications technology (ICT)</b></p> <p>Our high level review of ICT services, including aspects of security, identified areas of good practice and areas in which improvements could be made. Transport Scotland have considered the outcomes of this work and have planned actions to address issues. Audit Scotland will follow up planned actions as part of the 2007-08 audit.</p>	<p>The Audit Scotland report contains an action plan. Progress against this action plan will be reviewed by Corporate Finance quarterly.</p>	<p>Guy Houston – Director of Finance &amp; Corporate Services</p>	<p>April 2008</p>