

Transport Scotland

Report on the 2007/08 Audit

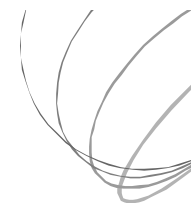


November 2008



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Executive Summary

Introduction

In 2007/08 we looked at 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 Position

The outturn for 2007/08 was a net operating cost of £1,892 million. This resulted in an underspend against the resource budget of £28 million. Total income for the year was £2.5 million and total expenditure was £1,895 million including programme expenditure of £1,879 million and administration costs of £16 million. Capital expenditure was £136 million, an overspend of £11 million against budget.

Scottish Ministers have agreed a budget for Transport Scotland of £1,987 million for 2008/09, a 2.9% decrease. This comprises £1,878 million to cover operating expenditure and £109 million of capital expenditure. Transport Scotland will face challenges to meet this reduced budget while absorbing pay inflation and other cost pressures.

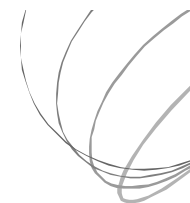
Financial Statements

We have given an unqualified opinion on the financial statements of Transport Scotland for 2007/08. 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.

Governance

Corporate Governance is concerned with the structures and process for decision making, accountability, control and behaviour at the upper levels of an organisation. Overall the corporate governance and control arrangements for Transport Scotland operated satisfactorily during the year, as reflected in the Statement on Internal Control. Arrangements for the declaration of interests by Board Members, however, could be strengthened to avoid public perceptions of any conflict of interest.

We examined the key financial systems which underpin Transport Scotland's control environment. We concluded that financial systems and procedures operated sufficiently well to enable us to place reliance on them. We reviewed arrangements surrounding the Concessionary Fares Scheme and confirmed improvements in the systems and procedures, and that on-going developments will further strengthen the control environment. However, we note that challenges remain in the Scheme becoming fully SMART-enabled by 2009/10.



Performance

Transport Scotland's Corporate Plan 2006-08 and Business Plan 2007/08 set out 5 high-level aims, each supported by a set of objectives and targets or milestones. The Annual Report for 2007/08 records progress against each target, with most of the targets planned for delivery in 2007/08 being achieved. The exceptions were the roll out of smartcard ticket machines to bus operators, which was recorded as delayed; and, of the targets relating to Transport Scotland's final aim of "Striving towards excellence by building our working principles into everything we deliver and into how we work as an organisation", 4 were partly achieved.

In June 2008 the Auditor General published his report "Review of major capital projects in Scotland". Although the report covers all central government and NHS projects, it is particularly important to Transport Scotland due to the large number of transport projects included in the Government's infrastructure investment programme. Audit work has also commenced on a review of the First ScotRail franchise and the First ScotRail's performance against the franchise terms. It is intended that the report will be published towards the end of 2008.

Best Value

During the year we continued to develop our approach to the audit of Best Value across the Scottish public sector. No specific audit work was carried out in respect of Best Value as part of the 2007/08 audit. However, a number of toolkits have now been developed and these will be used during the audit of Transport Scotland in 2008/09.

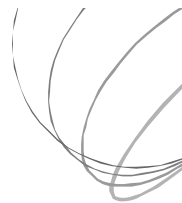
Looking forward

The final part of our report notes some key risk areas for Transport Scotland going forward. We highlight a number of national issues which affect all public sector bodies, including the introduction of Scotland Performs; the impact of International Financial Reporting Standards; and the review of data handling arrangements in public bodies across Scotland. Transport Scotland faces a number of other specific challenges over the next year to achieve its 2008/09 Business Plan targets for the planning and delivery of transport projects and initiatives, including its efficiency and environmental targets. We will continue to monitor the performance of Transport Scotland.

The assistance and co-operation given to us by Board members and staff during our audit is gratefully acknowledged.

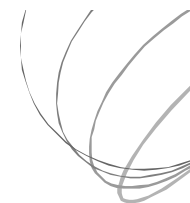
Audit Scotland

November 2008



Introduction

1. This report summarises the findings from our 2007/08 audit of Transport Scotland. The scope of the audit was set out in our Audit Plan, which was presented to the Audit Committee on 22 February 2008. The plan set out our views on the key business risks facing the organisation and described the work we planned to carry out on financial statements, governance and performance.
2. We have issued a range of reports this year, and we briefly touch on the key issues we raised in this report. Each report set out our detailed findings and recommendations and Transport Scotland's agreed response. Appendix A sets out the key risks highlighted in this report and the action planned by management to address them. Performance audit reports by the Auditor General for Scotland are published separately and available from Audit Scotland's website.
3. We would like to take this opportunity to express our appreciation for the assistance and co-operation provided by officers and members 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.



Financial Statements

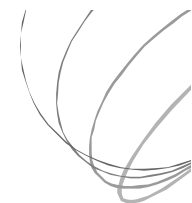
4. In this section we summarise key outcomes from our audit of Transport Scotland's financial statements for 2007/08, and comment on the key financial management and accounting issues faced. The financial statements are an essential means by which the Agency accounts for its stewardship of the resources available to it and its financial performance in the use of those resources.

Our responsibilities

5. 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
 - information which comprises the Management Commentary and the section Who We Are And What We Do included in the Annual Report is consistent with the financial statements
 - the regularity of the expenditure and receipts.
6. 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
 - assessing whether disclosures in the statement are consistent with our knowledge of Transport Scotland.

Overall conclusion

7. In relation to these responsibilities we have given an **unqualified** opinion on the financial statements of Transport Scotland for 2007/08.
8. The unaudited financial statements were provided to us in line with the agreed timetable, supported by a comprehensive working paper package. The good standard of the supporting papers and the timely responses from Transport Scotland staff allowed us to conclude our audit within the agreed timetable and provide our opinion to the Audit Committee on 22 August.



Financial Position

2007/08 outturn

9. Transport Scotland's net operating costs for the year were £1,892 million (2006/07: £1,756 million), including a notional capital charge of £483 million (2006/07: £451 million). Income was £2.5 million (2006/07: £0.7 million). Programme costs accounted for 99% of expenditure, with £768 million (2006/07: £757 million) spent on motorways and trunk roads activities, £678 million (2006/07: £650 million) on rail services, £174 million (2006/07: £162 million) on concessionary fares schemes; and £258 million (2006/07: £174 million) on major rail projects. Capital expenditure on the roads network in the year was £136 million (2006/07: £158 million).
10. Total outturn for the year was close to and within budget limits, with an underspend of £17 million (2006/07: overspend of £5.6 million), comprising an underspend on revenue expenditure of £28 million and overspend on capital of £11 million.

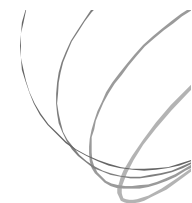
Performance against Budget 2007/08 (£000)

Resource Allocation (£000)	Budget	Actual Outturn	Difference
Operating Costs	820,499	786,927	33,572
Investment	598,321	624,262	(25,941)
Cost of Capital (notional)	501,247	480,847	20,400
Revenue Expenditure	1,920,067	1,892,036	28,031
Capital Expenditure	125,800	136,376	(10,576)
Total Outturn	2,045,867	2,028,412	17,455

11. At 31 March 2008, Transport Scotland held net assets of £14,391 million, an 8.9% increase from the £13,216 million of the previous year. This largely reflected Scotland's trunk roads network, which, including assets under construction had a net book value of £14,665 million at the balance sheet date, an 8.8% increase from the previous year's £13,482 million. The significant factor in the movement was indexation, which at £1,083 million (2006/07: £645 million) accounted for over 90% of the movement and was higher than the previous year primarily because of higher oil and other commodity prices.

2008/09 budget

12. Scottish Ministers have set Transport Scotland's initial budget for 2008/09 at £1,987 million. This includes £546 million to cover notional cost of capital, leaving an operating budget of £1,441 million, and is a decrease of £59 million (2.9%) on the previous year's budget. The budget breakdown is as follows:



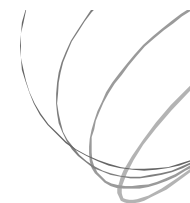
2008/09 Budget per 2007 Spending Review process £000

2007/08 budget	£000	change from 07-08 budget
Resource – Operating Costs	797,000	(2.9)%
Resource - Investment	534,800	(10.6)%
Cost of Capital (notional)	546,500	9.0%
Revenue	1,878,300	(2.2)%
Capital	108,900	(13.4)%
Total Operating Plan	1,987,200	(2.9)%

13. Transport Scotland is expected to achieve 2% of efficiency savings per year from 2008/09 to 2010/11. The main impact of the reduction in the budget from 2007/08 is on Major Public Transport Projects (Rail). These savings targets are challenging in light of oil-related cost increases and inflation in raw materials and pay.

Issues arising from the audit

14. As required by auditing standards we reported to the audit committee on 22 August 2008 the main issues arising from our audit. In line with our normal practice, we will also report separately to management less significant matters arising from the audit of the financial statements, which do not require to be reported here.
15. Transport Scotland consolidated the experience gained in preparing their first set of accounts in 2006/07 and from the review of their accounting policies. The issues raised previously were addressed over the course of the year and fewer issues were identified in the audit of the 2007/08 financial statements. The key issues reported were:
16. **Accounts Preparation** - As part of the accounts preparation and audit process Transport Scotland maintain an “unders and overs” schedule which tracks the accuracy of estimates made in the preparation of the accounts and recorded mis-statements which are identified during the audit. Within that schedule the largest item related to the over accrual of expenditure on roads maintenance expenditure of £7.6 million, of which £1.1 million relates to capital expenditure, while £6.5 million reflects an over-statement of expenditure in the Operating Cost Statement. This arose because of an error in the basis of calculating the estimate rather than a flaw in the estimating process itself. Transport Scotland have provided assurances that they will review their arrangements and update them as appropriate to allow detection of similar errors should they arise in draft figures next year.



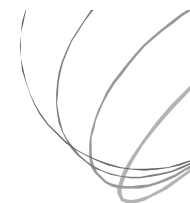
17. **Grant to the Edinburgh Trams project** – Transport Scotland makes a capped contribution to the costs of the Edinburgh Trams project, with payments made via City of Edinburgh Council (CEC). At 31 March 2008 Transport Scotland's financial statements included a prepayment of £22.2 million in respect of a contribution for the advance purchase of steel in order to mitigate the effects of price volatility and, to a lesser extent, exchange rate risk. This prepayment was made to CEC (as part of a larger payment of £38 million) on 28 March 2008, although it was not due until 'financial close' of contracts between CEC and the main contractors for the project (TramCo and InfraCo), and was based on the understanding that these contracts would be completed in early April. However, contracts were not formally completed until 14 May 2008. Therefore the £22.2 million for the advance purchase of steel was paid out in advance of need. This would have had consequent borrowing and opportunity cost implications for central government.

18. **Grant to the Edinburgh Trams project, Accounting Policies** - Transport Scotland record expenditure on the Edinburgh Trams project on the basis of the underlying activity. For 2007/08 this comprises the contract payments due, adjusted for prepayments. During 2007/08, a compatible position was recorded by Transport Scotland, CEC and tie Ltd (the Council's subsidiary which is managing the project). However, in producing the statutory accounts for tie Ltd, an adjustment was made to the position recorded in the management accounts, which created some uncertainty as to the appropriateness of the figures recorded in the Transport Scotland accounts at a late stage of the completion of the accounts and audit process. Although this has been satisfactorily resolved for this year, Transport Scotland should consider reviewing the accounting for projects of this nature to ensure that:

- there is a consistency of approach across projects
- for projects involving local authorities and other bodies included in Whole of Government Accounts, in-year transaction values and year-end balances are agreed promptly.

Regularity Assertion

19. The Public Finance and Accountability (Scotland) Act 2000 imposes a responsibility on auditors that requires us to certify that, in all material respects, the expenditure and receipts shown in the accounts were incurred or applied in accordance with applicable enactments and guidance issued by the Scottish Ministers. We have been able to address the requirements of the regularity assertion through a range of procedures, including written assurances from the Accountable Officer as to his view on adherence to enactments and guidance. No significant issues were identified for disclosure.



Governance

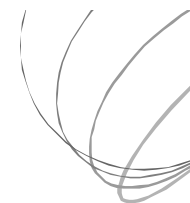
20. This section sets out our main findings arising from our review of Transport Scotland's governance arrangements. We focussed on:
- review of the key systems of internal control
 - review of the developing arrangements for the Concessionary Fares Schemes
 - internal audit
 - aspects of information and communications technology (ICT).
21. We also discharged our responsibilities as they relate to the prevention and detection of fraud and irregularity, standards of conduct, and the organisation's financial position (see paragraphs 9 to 13). Our overall conclusion is that arrangements within Transport Scotland are sound and have operated through 2007/08.

Overview of Corporate Governance arrangements

22. In 2006/07 we reported that Transport Scotland had made significant progress towards establishing appropriate corporate governance arrangements. During 2007/08 Transport Scotland continued to develop and embed these arrangements, in particular, we note the significant progress made in relation to arrangements covering concessionary fares and steps taken to evaluate corporate services staffing structures, including the respective benefits of centralised versus devolved arrangements for finance and IT.

Systems of internal control

23. Key controls within systems should operate effectively and efficiently to accurately record financial transactions and prevent and detect fraud or error. This supports a robust internal control environment and the effective production of financial statements. In the annual report for 2007/08, the head of internal audit provided his opinion that, based on the internal audit work undertaken during the year, there was substantial assurance on the adequacy and effectiveness on the systems of internal control.
24. As part of our audit we reviewed the high level controls in a number of Transport Scotland's systems that impact on the financial statements. Our overall conclusion was that key controls were operating effectively.



25. As a number of the Transport Scotland's financial systems are provided by the Scottish Government, we also relied on the work of the Scottish Government external audit team to assess the effectiveness of key internal controls in the following areas:
- 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
 - the central aspects of the operation of the fixed asset system
 - the central aspects of the operation of the payroll and subsistence systems.
26. The Scottish Government auditors concluded that adequate assurance could be taken from the key controls in all main financial systems with the exception of payroll, where only limited assurance could be taken. As a result the Scottish Government external audit team carried out additional substantive testing and we also undertook additional audit testing on payroll to ensure that Transport Scotland's financial statements were not materially mis-stated.

Concessionary Fares Scheme

27. In 2006/07 a number of issues arose from our audit of the Concessionary Fares Schemes particularly around the evidence and assurance available that Transport Scotland was reimbursing bus operators only for eligible persons travelling on eligible journeys. As part of our 2007/08 audit work we reviewed the progress that Transport Scotland had made in developing the Concessionary Fares Scheme.
28. Our review identified that Transport Scotland has made significant progress in developing the control environment particularly around inspections of bus operators, on bus surveys and the validation of operator claims under the Scheme. This, together with our audit testing of claims, provided us with sufficient assurance on Concessionary Fares expenditure and the disclosures recorded in the Statement on Internal Control.
29. However a number of the aspects of the scheme are still developing. In particular there remain challenges in delivering the SMART enabled arrangements, using technology to streamline procedures and provide control features. The key issues are:
- local authorities are responsible for the SMART card developments under the National Entitlement Card/ "Customer First" arrangements including ensuring the eligibility of users of SMART cards. Arrangements within Transport Scotland and local authorities continue to develop and, to date, there is no evidence of significant issues arising in relation to the eligibility of SMART card users
 - the Service Level Agreement with the Improvement Service in relation to National Entitlement Card/ "Customer First" has expired and Transport Scotland is in the process of establishing



contractual relationships with the local authorities leading on the issuing of National Entitlement Cards

- the roll out of the card-reading ticket machines and back office systems to the bus operators is taking longer than originally planned.

30. The development of the SMART enabled arrangements will further strengthen the control environment, but this is taking longer than originally envisaged and it is now expected that they will be operational in 2009/10.
31. 2007/08 also saw the implementation of a limit of £163 million on expenditure on claims made under the Concessionary Fares Scheme, with eligible claims restricted by £2.4 million to meet the expenditure limit. Although we have not considered future funding in any detail, estimates suggest there will be upward pressure on costs because of greater numbers of eligible persons and increased demand owing to the popularity of the Scheme, together with increased cost of fares.

Standards of Conduct

32. In general, Transport Scotland has appropriate arrangements in place to prevent and detect fraud, inappropriate conduct and corruption, including policies and codes of conduct for staff and board members. In our November 2007 overview of corporate governance we highlighted that a register of Board Members' interests is maintained by the Chief Executive's office and is available for public inspection. We noted, however, that declarations of interest do not appear as a standing item on all Board agenda and minutes. Good practice would require Board members to make a declaration of any personal and professional interest in a matter and withdraw from the Board meeting during discussion of it.

Internal Audit

33. 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 2007/08 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.
34. Taking into account the findings of the Scottish Government external audit team's review of the Division in general and our specific review of the Division's work on Transport Scotland, we concluded that the division operates in accordance with the Government Internal Audit Standards. Therefore we placed reliance on their work in the following areas: Road Scheme Construction (TRIPS Directorate); Trunk Roads Maintenance, (TRMN Directorate); TRMN Directorate Governance Review; Minor Rail



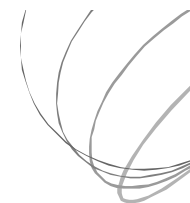
Infrastructure Projects (Rail Directorate); and, Accident Investigation and Prevention (TRNM directorate).

Statement on Internal Control

35. The Statement on Internal Control provided by Transport Scotland's Accountable Officer reflects the main findings from both external and internal audit work. The statement records management's responsibility for maintaining a sound system of internal control and sets out the Agency's approach. The statement follows up on the position recorded in 2006/07 on the Older and Disabled Persons National Concessionary Fares Scheme, reporting that control processes had been strengthened. The findings of our audit work have not identified anything that is inconsistent with the information and conclusions contained in the Statement on Internal Control.

Information and Communication Technology

36. As part of our 2007/08 audit we followed up the 2006/07 Computer Services Review report to determine what progress had made in implementing the agreed actions. We identified that Transport Scotland had taken all the planned interim actions and had also made progress in identifying the relevant forward looking actions. We noted that some of the outstanding actions which have been identified are reliant on the completion of a corporate restructuring exercise.

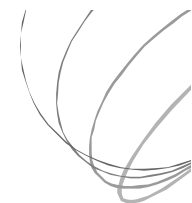


Performance Management

37. Public audit is more wide-ranging than in 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.
38. 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.

Best Value developments

39. The positive impact of the Best Value concept in local government led Scottish Ministers to introduce a non-statutory Best Value duty on all public sector accountable officers (i.e. across health and central government) in 2002. This was reinforced by refreshed Ministerial guidance in 2006, highlighting the importance that the Scottish Government places on Best Value as a means of supporting public service reform.
40. That position was again re-iterated in the Scottish Government's recent response to the Crerar scrutiny review which credited the Best Value regime as a key driver of modernisation and improvement in public services. Audit Scotland is committed to extending the Best Value audit regime across the whole public sector and significant development work has taken place over the last year.
41. The framework for our proposed Best Value audit approach was agreed by Audit Scotland's Corporate Management Team in September 2007. It is based on the key principles of flexibility and proportionality; alignment and integration with our existing activities; being delivered within our existing resources; and, with an evolutionary implementation.
42. Using the Scottish Government's nine best value principles as the basis for our audit activity, we have identified five priority development areas (Use of Resources, Governance and Risk Management, Accountability, Review and Option Appraisal, and Joint Working) for our initial development work.
43. Currently we are concentrating on the development of Use of Resources audit toolkits, focusing initially on Financial Management, Efficiency, and Information Management. These toolkits are being piloted in a sample of NHS and central government clients during 2007/08 and 2008/09. Developed toolkits will also be made available to public bodies to consider for self assessment. Audit Scotland will use the toolkits during the 2008/09 audit of Transport Scotland.



44. During the 2007/08 audit we discussed our approach to the audit of Best Value with the Audit Committee. No specific reviews of Best Value or Best Value characteristics were undertaken as part of the 2007/08 audit, however, positive assurance on arrangements to secure continuous improvement is provided by our work, as recorded in this report, and that of internal audit.

Progress against targets

45. Transport Scotland's Corporate Plan 2006-08 and Business Plan 2007/08 sets out 5 high-level aims, each supported by a set of objectives and targets or milestones. The Annual Report for 2007/08 records progress against each target in terms of 'achieved' or 'not achieved'. Most of the targets which were planned to be achieved in 2007/08 were achieved. A brief summary and commentary by aim/business priority is provided below.

Summary progress against 2007/08 targets by business aim

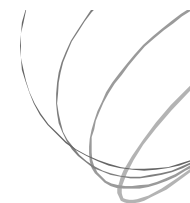
Business aim	Commentary on achievement of targets
Ensure that Scotland's rail and trunk road systems are managed efficiently, economically and effectively	All targets achieved, comprising 4 road and 3 rail targets
Establish and run the national concessionary travel schemes	Annual targets for enhancing the 2 schemes were achieved. Progress on wide availability target classed as delayed because of delay in roll out of Smart-card ticket machines.
Deliver the Scottish Minister's committed programme of enhancements to Scotland's rail and trunk road infrastructure	All targets achieved, comprising 7 road and 4 rail targets.
Help to build Scotland's National Transport Strategy(NTS) by recommending and advising on investment priorities for tomorrow's rail and trunk road networks	All 5 targets achieved.
Strive towards excellence by building our working principles into everything we deliver and into how we work as an organisation	5 targets were rated as achieved, with 4 assessed as partly achieved.



National Studies

How Government Works: major capital projects

46. The Audit Scotland report on major capital projects was published on 24 June 2008. The study presented a picture of how Scottish Government, agencies and NDPBs have been and are delivering major capital projects. It provided Parliament with the first wide view report on the delivery of major capital projects to time, cost and quality. Audit Scotland obtained completed project data from a survey of these projects. In addition there was a high-level assessment on 5 completed and 15 in-progress projects on performance to time, costs and quality and project management arrangements.
47. The report covers all major capital projects in central government and NHS. However, it is particularly important to Transport Scotland due to the large number of transport projects included in the Government's infrastructure investment programme. Of the 58 projects (43 completed and 15 current) commented on in the report 16 are transport projects, including high level assessments of 1 completed project and 6 projects which are in progress.
48. Key messages arising out of the report were as follows:
 - in general, the achievement of cost and time targets improved significantly as projects progressed. While there was over optimism at project approval stage, performance improved after contracts were awarded as plans are more certain and risks clearer
 - most completed projects have successfully delivered the required roads, hospitals and other assets, and all current projects are forecast to do so. However, few projects have been evaluated against the expected wider benefits which originally justified the investment
 - project management and governance arrangements within individual projects are broadly effective, although room for improvement remains. A more strategic approach to managing the programme of capital projects could improve value for money.
49. The report made a number of recommendations for both the Scottish Government and public bodies. It recommended that the Scottish Government should report in public on the performance of projects, particularly any reasons for changes to costs and timing and what lessons can be learned from completed projects. It also made several recommendations to public bodies on strengthening business cases, improving project management and governance arrangements, and post project reviews.



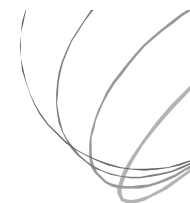
50. In addition to the report a good practice checklist for public bodies was also published. This is based on the findings from the review and aims to help public bodies improve their project management and governance of major capital projects. It is not intended to replace good practice or guidance that already exists but is aimed at assisting senior decision-makers, including governing bodies and audit committees to self-assess their processes and procedures and constructively challenge proposals and bids before they make decision to invest in projects.

Scotrail Franchise

51. During 2008 work commenced on a review to assess Transport Scotland's management of the First ScotRail franchise and First ScotRail's performance against the franchise terms. It is intended that the Auditor General will publish his report towards the end of 2008.

Future studies

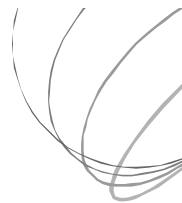
52. Audit Scotland is planning a study on '*Strategic procurement*' to provide an assessment of public sector progress against the McClelland recommendations to improve public sector procurement. The study will also seek to quantify the efficiency savings being realised through improved procurement practices and the extent to which cash has been released for other priorities. Planned improvements will also be commented on and good practice identified. Scoping work is currently underway for the study and it is anticipated that a small number of public bodies may be involved.
53. At the end of June, Audit Scotland issued a '*Consultation on Proposals for National Performance Audit Studies - October 2008 to March 2010*'. The paper listed 37 potential areas for examination across the Scottish public sector. Views have been received from our stakeholders about which of these potential studies should be taken forward to form our forward programme of work over the next two years. These views will ensure our work is broad and balanced, and focuses on where we can have most impact.



Looking Forward

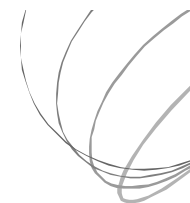
54. Transport Scotland faces a number of challenges in 2008/09, some of which are recorded earlier in this report. These include::

- **International Financial Reporting Standards (IFRS)** – As part of the UK Budget 2007 the Chancellor announced that the timetable for IFRS implementation was to be extended by a year with central government accounts in Scotland to become IFRS compliant with effect from the 2009/10 financial year. The Scottish Government have notified central government bodies that they will be required to produce shadow IFRS based accounts for the financial year in 2008/09, including a restated balance sheet as at 1 April 2008. A detailed timetable and list of requirements is awaited from the Scottish Government. This process may require significant resource to complete and it will be important that the restatement of the 1 April 2008 balance sheet is tackled early in 2008/09, together with creating a plan to manage the transition from existing arrangements to accounts prepared under IFRS.
- **Scotland Performs** – The Scottish Government is continuing to develop its approach to performance management based on a National Performance Framework and outcome agreements. The National Performance Framework is based on the outcome based 'Virginia-style' model of performance measurement and reporting. In support of this the Scottish Government has developed a new electronic tool and website to communicate to the public on Scotland's progress. This will include progress on overall delivery of the administration's purpose for Government, the five strategic objectives for Scotland and other aspects of the outcomes based National Performance Framework. We will consider how Transport Scotland is addressing these developments as part of the 2008/09 audit.
- **Future funding regime** – Budgets for 2008/09 and the immediate future will need to be managed within a tighter funding regime. This includes significantly less scope for the application of end of year flexibility for the Government, with HM Treasury, until the next Spending Review; no option to transfer funds from capital to revenue; and the potential impact of the introduction of International Financial Reporting Standards (IFRS), particularly on PFI, leases and infrastructure accounting. The challenge for Transport Scotland, together with Scottish Government colleagues, is to manage this tighter funding regime against the background of changes in the budget and accounting framework, particularly on the introduction of IFRS.
- **Budget pressures in 2008/09** – Transport Scotland is facing a 2.9% reduction in overall budget from 2007/08 levels. The main impact of the reduction in the budget from 2007/08 is on the level of planned expenditure on Major Public Transport Projects (Rail). Transport Scotland will face challenges in meeting this budget in the face of cost pressures, such as those relating



to higher oil prices and through inflation in raw materials and pay; and through upward pressure on the costs, such as those of the Concessionary Fares Scheme because of greater numbers of eligible persons; increased demand owing to the popularity of the Scheme; and increased cost of fares.

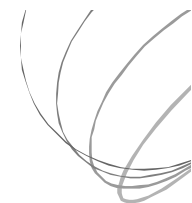
- **Achieving 2008/09 business plan targets** - Transport Scotland's 2008/09 Business Plan sets a number of specific targets for the planning and delivery of transport projects and initiatives, such as devising a procurement strategy for the Forth Replacement Crossing; commencing work on the M74 and M80 projects; completing the Upper Forth Crossing at Kincardine and the Dalkeith Bypass; implementing the planned roll out of smart technology as part of the Concessionary Fares Scheme; and other efficiency and environmental targets. We will continue to monitor the performance of Transport Scotland.
- **Data handling** – The Scottish Government carried out a review of data handling arrangements in Scotland, in response to failures in UK government bodies' procedures and practices during 2007. The review considered current policies and procedures on data protection, consistency with government standards and local arrangements for implementation of procedures. A report published in June 2008 made recommendations for a higher level of oversight and guidance from the Scottish Government and suggested that there was a need for further measures to improve the security of sensitive information. We will monitor Transport Scotland's response to the review and action taken as part of our 2008/09 audit.



Appendix A: Action Plan

Key Risk Areas and Planned Management Action

Action Point	Risk Identified	Planned Action	Responsible Officer*	Target Date*
1.	<p>Accounts Preparation</p> <p>Expenditure on roads maintenance included an over-accrual of £7.6 million. This arose because of an error in the basis of calculating the estimate rather than a flaw in the estimating process itself.</p> <p>While estimating figures is an essential element of preparing accounts to an early timetable, it creates a risk of mis-statement.</p>	<p>We have reviewed the circumstances of this particular mis-statement and taken appropriate corrective action. We will review arrangements more generally in order to identify means to minimise the risk of similar mis-stated estimates remaining undetected in the draft financial statements.</p>		
2.	<p>Grant to the Edinburgh Trams project. Timing of payments.</p> <p>Transport Scotland prepaid £22 million of grant on the Edinburgh Trams project to facilitate the advance purchase of steel in order to mitigate the effects of price volatility and, to a lesser extent, exchange rate risk. This prepayment was made to City of Edinburgh Council (CEC), as part of a larger payment of £38 million, on 28 March 2008 and was based on the understanding that contracts with the main contractors on the project would be completed in early April. However, contracts were not formally completed until 14 May 2008.</p> <p>There is a risk that making payments in anticipation in this way will give rise to borrowing and opportunity cost implications for central government.</p>	<p>We will review projects to identify any situations in which similar circumstances may arise and structure arrangements to minimise any potential adverse implications on borrowing and other activity.</p>		



Action Point	Risk Identified	Planned Action	Responsible Officer*	Target Date*
3.	<p>Grant to the Edinburgh Trams project, Accounting Policies</p> <p>Expenditure on the Edinburgh Trams project is recorded on the basis of the underlying activity. For 2007/08 this comprises the contract payments due, adjusted for prepayments. During 2007/08, a compatible position was recorded by Transport Scotland, CEC and tie Ltd (the Council's subsidiary which is managing the project). However, in producing the statutory accounts for tie Ltd, an adjustment was made to the position recorded in the management accounts, which created some uncertainty as to the appropriateness of the figures recorded in the Transport Scotland accounts at a late stage of the completion of the accounts and audit process. This was satisfactorily resolved for 2007/08.</p> <p>There is a risk that similar projects could be adopting different accounting treatments, which could create uncertainty at the key stage of completion of the accounts and difficulty in agreeing in-year transaction values and year-end balances are agreed promptly for projects involving local authorities and other bodies included in Whole of Government Accounts.</p>	<p>We will review projects to identify any situations in which there is the possibility of differing accounting arrangements between participants; and take steps to ensure that we are in a position to agree in-year transaction values and year-end balances promptly for projects involving local authorities and other bodies included in Whole of Government Accounts.</p>		

* at the date of issuing this report, we are awaiting confirmation of Responsible Officer and Target Date from Transport Scotland.