Transport Scotland

Report on the 2008/09 audit

December 2009

Audit Scotland

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Contents

Key messages

In 2008/09 we looked at the key strategic and financial risks being faced by Transport Scotland. We audited the financial statements and we also reviewed the use of resources and aspects of performance management and governance. This report sets out our key findings.

Financial statements

We have given an unqualified opinion on the financial statements of Transport Scotland for 2008/09. 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.

In the financial statements section of the report we summarise issues that arose from that part of the audit, including Remuneration Report disclosures, and make recommendations for improvement. We also comment on Transport Scotland's preparation for the adoption of International Financial Reporting Standards (IFRS) from 2009/10 onwards.

Financial position and use of resources

The net outturn for 2008/09 was £2,055 million against a resource budget of £2,083 million, a net under spend of £28 million. This comprises net operating costs of £1,892 million (2007/08: £1,892 million) and net capital expenditure of £163 million (2007/08: £136 million).

Scottish Ministers have agreed a budget for Transport Scotland of £2,229 million for 2009/10, an increase of 7.5%. This comprises £2,053 million to cover net operating costs and £176 million of net capital expenditure. The increase reflects the funding required for the approved programme of activity and some technical changes required as a result of the switch to IFRS.

Transport Scotland has been expected to achieve 2% of efficiency savings per year. This translated into a target of £30 million for 2008/09, with Transport Scotland recording in their Annual Report achieved efficiencies of £40 million through a range of measures.

Governance and accountability

Corporate Governance is concerned with the structures and process for decision making, accountability, control and behaviour at the upper levels of an organisation. We examined the key financial systems which underpin Transport Scotland's control environment. We concluded that the financial systems and procedures operated sufficiently well to enable us to place reliance on them. Overall, we concluded that the corporate governance and control arrangements for Transport Scotland operated satisfactorily during the year, as reflected in the Statement on Internal Control. The Statement on Internal Control drew attention to delays in the implementation of the electronic smart card project, which is part of the development of the Concessionary Travel Schemes; and that a status review had been commissioned. The Statement also included a reference to the Audit Scotland review of the ScotRail Franchise extension and the consideration of this by the Public Audit Committee of the Scottish Parliament noting that the arrangements for registering and managing potential conflicts of interest arrangements had since been reinforced.

Performance

Transport Scotland's Corporate Plan 2008-11 and Business Plan 2008/09 set out 4 high-level aims, each supported by a set of objectives and targets or milestones. The Annual Report for 2008/09 records progress against each of the 43 targets established. Most of the targets planned for delivery in 2008/09 were achieved or partly achieved as appropriate, with some assessed as on-going.

In addition, the Corporate and Business Plans outline Transport Scotland's Working Principles. These are summarised as "Strive for excellence in everything we do", but are encapsulated in five core principles. For 2008/09 12 targets were set, of which 10 were assessed by Transport Scotland as achieved, with 2 as on-going.

In the sections of the report covering Use of resources, Governance and Performance we also draw attention to relevant National Studies carried out by Audit Scotland.

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 continuing development of the National Performance Framework; the potential impact of the tighter funding position going forward on the need for prioritising spending, realising efficiencies and managing budgets; the consequences of the introduction 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 2009/10 Business Plan targets for the planning and delivery of transport projects and initiatives, including its efficiency and environmental targets. We will continue to monitor Transport Scotland's performance.

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

Audit Scotland

December 2009

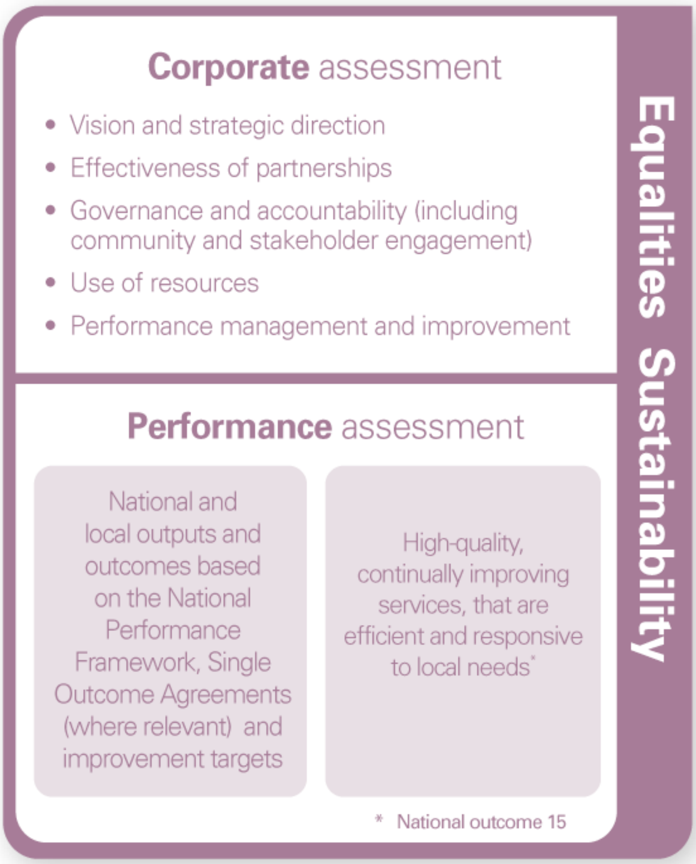
Introduction

1. This report summarises the findings from our 2008/09 audit of Transport Scotland. The scope of the audit was set out in our Audit Plan, which was presented to the Audit Committee on 20 March 2009 . This 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, performance and governance.

2. We have issued a range of reports and management letters 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 of this report sets out the key risks highlighted in this report and the action planned by management to address them.

3. Best value duties apply across the public sector and, in central government, best value is a formal duty on all Accountable Officers. Audit Scotland has adopted a generic framework for the audit of best value across the public sector and throughout this report we comment on aspects of Transport Scotland's arrangements.

Exhibit 1: Framework for a best value audit of a public body



4. Our comments are made on the basis of information made available in the course of the annual audit. We do not make an overall best value judgement because we do not have enough evidence to conclude on all relevant areas. Our intention is to build up the corporate assessment over time. This report is the first step towards that goal.

5. Another building block for our assessment of best value is the national study programme carried out by Audit Scotland on behalf of both the Auditor General for Scotland and the Accounts Commission. We mention the key findings from all relevant reports, and the implications for Transport Scotland, throughout this report. Full copies of the study reports can be obtained from Audit Scotland's website, www.audit-scotland.gov.uk.

6. We would like to take this opportunity to express our appreciation for the assistance and co-operation provided by the management and board 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.

Financial Statements

7. In this section we summarise key outcomes from our audit of Transport Scotland's financial statements for 2008/09 and the accounting issues faced. The financial statements are an essential means by which the organisation accounts for its stewardship of the resources available to it and its financial performance in the use of those resources.

Our responsibilities

8. 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;
- whether the information which comprises the Management Commentary and the section Striving Towards Excellence included in the Annual Report is consistent with the financial statements;
- the regularity of the expenditure and receipts.

9. 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

10. We have given an unqualified opinion on the financial statements of Transport Scotland for 2008/09.

11. 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 most of our audit within the agreed timetable and report the position to the Audit Committee on 24 August 2009. Following on from that Committee meeting there were discussions with officials from both Transport Scotland and the Scottish Government, in particular in relation to Remuneration Report disclosures (see paragraphs 13 to 17). Matters were resolved and the outcomes were confirmed with Audit Committee members in November 2009.

Issues arising from the audit

12. As required by auditing standards we reported to the audit committee on 24 August 2009 the main issues arising from our audit, with an update in November 2009. 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. Overall, Transport Scotland continues to make progress consolidating the experience gained in preparing their first 2 sets of accounts in 2006/07 and 2007/08. The key issues were as follows:

Remuneration Report

13. In November 2008 the Director of Finance and Corporate Services left Transport Scotland by mutual agreement. To facilitate this, the Scottish Government put in place a compromise agreement. As part of our audit we reviewed the remuneration paid to the Director of Finance and Corporate Services up to this date to confirm that it was appropriately approved, in accordance with rules and regulations and that the value for money had been reasonably considered. The findings of our audit confirmed this to be the case.

14. The Financial Reporting Manual requires the details of the salary and allowances of senior staff to be disclosed in the remuneration report within the annual report and accounts for all relevant public bodies, including details of any compensation package. Non-disclosure is only acceptable where publication would:

    - prejudice the rights, freedom or legitimate interests of the individual; or
    - cause or be likely to cause substantial damage or distress to the individual or another, and that damage or distress would be unwarranted.

15. Examples of grounds include national security or where an individual may be at risk. Within Scotland there is also a caveat that the prior consent of named individuals must be sought to disclose this information.

16. Transport Scotland’s Annual Report and Accounts do not contain details of the remuneration paid to the Director of Finance and Corporate Services during 2008/09, although comparative information for 2007/08 is included. The Scottish Government has indicated that under the Data Protection Act 1998 Transport Scotland is not able to disclose this information unless the Director of Finance and Corporate Services consented. His contract of employment had no specific clause requiring him to disclose the information and he declined for his information to be disclosed in line with the caveat in the Financial Reporting Manual.

17. Whilst we consider the non-disclosure of the Director of Finance and Corporate Services remuneration details to comply with guidance, and that legal advice has concluded that for Transport Scotland to disclose this unilaterally would breach their responsibilities under the Data Protection Act 1998, a key principle in the use of public money is that its use is open and transparent, and open to public scrutiny. This is recognised in the Scottish Public Finance Manual in relation to Severance, Early Retirement and Redundancy Terms, which states that “any undertakings about confidentiality should leave transactions open to proper public scrutiny”. To ensure that there is effective transparency and public scrutiny in the remuneration to senior staff within public bodies it is our view that:

    - the contracts of senior staff should include the requirement for them to disclose their remuneration within the Annual Accounts and Report of the relevant body as standard, with no option to refuse disclosure; and
    - compromise agreements, whilst being a legitimate method of enabling effective organisational management, should not prevent the appropriate disclosure of remuneration information including compensation packages.

18. On 17 February 2009 Malcolm Reed retired from his position as the chief executive of Transport Scotland. Dr Reed’s normal retirement date would have been November 2009 but after discussion at the end of 2008 it was agreed with Scottish Government senior management that it would be mutually convenient for Dr Reed to finish in February. Dr Reed’s contractual notice period was 3 months. In this instance the Scottish Government exceptionally agreed to pay Dr Reed 6 months salary in lieu of notice of £61k, along with untaken annual leave, as they considered it to provide organisational advantages in respect of Transport Scotland’s Delivery programme.

Qualitative aspects of accounting practice and financial reporting

19. **Valuation of the trunk roads network –** during 2007/08 we agreed with Transport Scotland that it would be acceptable to bring forward the indexation date of the annual roads valuation from 31 March to 31 December, with the caveat that the position would be reviewed for significant movements in relevant indices between December and March. This policy is in line with England and Wales. Since agreeing this change, in both 2007/08 and 2008/09 there have been unusually high movements in indices in the final quarter of the year and Transport Scotland has put through adjustments to the accounts in both years. For 2008/09 the value of the road network was reduced by a net amount of £306 million, matched by a reduction in the revaluation reserve (in 2007/08 the adjustment increased the value of the road network by a net £390 million). We confirm that this significant adjustment to the recorded value of the road network is reasonable and in line with the established accounting policy.

20. **Compulsory purchase of land** – Transport Scotland are reliant on the Valuation Office Agency (VOA) to determine the compensation paid and the provision recorded in the accounts for the

compulsory purchase of land. During 2008/09 Transport Scotland re-assessed the provision for the M74 extension, increasing the provision by £13.5 million. Currently the information provided by the VOA excludes VAT, any interest due and fees. Many commercial concerns are now requesting that compensation due is paid gross of VAT.

21. This position was discussed with Transport Scotland. It was recognised that the existing regime was broadly fit for purpose, but could be enhanced. For example, for larger projects such as the M74 extension, Transport Scotland could keep a more detailed record of the compulsory purchase transactions that would most influence the value of the provision; and that consideration be given to incorporating VAT in the values included in the provision in relation to compensation payable to commercial organisations. An approach of this nature would assist Transport Scotland in preparing and monitoring budget and outturn in this area.

Action plan 1

22. **Accounting for rail expenditure** – 1 April 2009 is the start of the next five year control period for regulated UK rail activity. In 2008-09 there was a reduction in the major rail projects funded direct by Transport Scotland as the activity of the previous control period wound down (a reduction from £250 million in 2007/08 to £128 million in 2008/09). In the new control period Transport Scotland will make increasing use of Network Rail funding for major projects. Within the regulatory regime Network Rail has some, limited, scope to fund capital projects from its own resources or borrowing, with the costs of funding these projects recovered from increased future annual grant payments to Network Rail.

23. The changing pattern of rail funding is a significant development. We have discussed this with Transport Scotland and agreed that it would be appropriate for the annual report and accounts to reflect this by the disclosure of relevant information in the annual report, management commentary, accounting policies and commitments note. We will continue to liaise with Transport Scotland in 2009/10 in the light of actual activity and the introduction of International Financial Reporting Standards.

Other matters arising

24. **Grant to 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). In 2007/08 we drew attention to 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. We were concerned that central government funds had been paid out in advance of need, with consequent borrowing and opportunity costs for central government. At 31 March 2009 there had been almost no draw down against this prepayment, although following the year end steel is being purchased and the prepayment utilised.

25. Also, at the time of the completion of the audit fieldwork in July 2009, it was acknowledged that, for a variety of reasons, the approved cost estimates and delivery dates for the Edinburgh trams project will not be met; and that line 1b will not be built as part of this project as originally intended. As at October 2009 formal dispute resolution procedures have been implemented and the outcome is awaited in January 2010. It has been recognised that it will be difficult to deliver the existing project within the overall budget of £545 million and implementation is now forecast for 2012. Given that Transport Scotland is only committed to a capped contribution of £500 million, it is not clear at present what the implications of these factors may be for Transport Scotland, if any, but there is a potential risk to reputation. We will continue to liaise with Transport Scotland and with colleagues in Audit Scotland who audit CEC and our Public Reporting Group to monitor the impact of developments and whether there is a need for any further audit work in this area to identify any lessons to be learned.

26. **Recovery of duplicate payment** – During 2008/09 Transport Scotland recovered a duplicate payment of £0.9 million that had been made on a capital roads project in 2004/05. The duplicate payment arose because it was initially approved as a BACS payment, but for operational reasons a bank transfer was considered more appropriate; unfortunately the instruction to cancel the original BACS payment was not actioned. While it is unsatisfactory that this duplicate payment went undetected for such a long period, there are a number of factors that provide assurance that this is not a widespread risk to Transport Scotland: the duplicate was detected by a review by Transport Scotland; the contractor was subject to a take over, with the new contractor finishing the contract; and there was still a retention on the contract. We discussed the circumstances of this issue with Transport Scotland and are satisfied that they have taken sufficient steps to ensure that the risks of similar undetected duplicate payments are minimised

Regularity

27. 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; and can confirm that there are no issues to bring to attention.

International financial reporting standards (IFRS)

28. As announced by the Chancellor in the 2008 Budget report on 12 March 2008 (Budget report paragraph C103), Government departments and other public sector bodies will report using International Financial Reporting Standards (IFRS) from 2009/10. The Scottish Government announced on 25 April 2008 that all Scottish Government Departments, Executive Agencies, Health

Bodies and Non-Departmental Public Bodies would be required to produce shadow IFRS based accounts for financial year 2008/09. This was to include a restated balance sheet as at 1 April 2008.

29. In terms of the audit of the IFRS opening balance sheet at 1 April 2008, there were two key dates to achieve as outlined below:

- **28 November 2008 –** opening 2008 IFRS-based balance sheets were to be presented to auditors for dry-run audit
- **28 February 2009** – dry-run audit of opening balances was to be completed, resulting in a letter to management highlighting the work done, auditors' findings and areas for further work.

30. The opening balance sheet and supporting documentation were submitted by Transport Scotland for audit review by the deadline date of 28 November 2008. The restated balance sheet and supporting working papers were comprehensive and Transport Scotland identified issues that required further consideration. We carried out a review of the restated balance sheet and reported at 27 February 2009; and again on 7 May 2009 with an update that clarified the position on the restatement of PFI projects and Financial Instrument adjustments.

31. The remaining outstanding item was clarification as to whether guarantees provided by the Department for Transport in relation to rail activity may have a read across to Transport Scotland. From our discussions with Transport Scotland and the National Audit Office we have come to the view that guarantees provided, for example, in relation to Network Rail borrowing and the Channel Tunnel are for the Department for Transport and that Scottish Ministers will not have a pro-rata share of any call on a guarantee that may emerge.

32. Scottish Government budgets for 2009/10 are likely to require finalisation prior to the agreed timetable for 2008/09 IFRS dry run accounts and for that reason we have had on-going discussions with Transport Scotland on the accounting and budgeting treatment of expenditure on roads and rail. We are also discussing PFI in light of updated budgeting guidance.

33. We made some recommendations for the delivery of the next stage of IFRS reporting – the production of the shadow accounts for 2008/09, and will consider progress on these when we review the shadow accounts later in 2009.

Use of Resources

34. Sound management and use of resources (people, money and assets) to deliver strategic objectives is a key feature of best value. This section sets out our main findings from a review of Transport Scotland's

- financial position
- financial management
- management and use of information and communications technology (ICT).

Financial Position

2008/09 outturn

35. Total outturn for the year was close to and within budget limits, with an underspend of £28 million (2007/08: overspend of £17 million), comprising an underspend on revenue expenditure of £70 million and an overspend on capital of £42 million.

Performance against Budget 2008/09 (£million; by Budget category)

Resource Allocation (£million)	Budget	Actual Outturn	Difference
Operating Costs	877	870	7
Investment	526	470	56
Cost of Capital (notional)	568	561	7
Revenue Expenditure	**1,971**	**1,901**	**70**
Income	**0**	**(9)**	**9**
Net Revenue Expenditure	**1,971**	**1,892**	**79**
Capital Expenditure	112	163	(51)
Total Net Outturn	**2,083**	**2,055**	**28**

36. Transport Scotland's net operating costs for the year were £1,892 million (2007/08: £1,892 million), including a notional capital charge of £510 million (2007/08: £483 million). Income was £9.3 million (2007/08: £2.5 million). Programme costs accounted for 99% of expenditure. As recorded in the financial accounts, expenditure by activity is analysed as follows: £847 million (2007/08: £766 million) on motorways and trunk roads activities; £703 million (2007/08: £678 million) on rail services; £193 million (2007/08: £174 million) on concessionary travel schemes; and £133 million (2007/08: £258 million) on major rail projects. Capital expenditure on the roads network in the year was £163 million (2007/08: £136 million).

37. In comparison to the prior year the main changes in revenue expenditure were an increase in expenditure on motorways and trunk roads (£80 million) and a reduction in expenditure on major rail projects (£120 million). Much of the increase in motorways and trunk roads expenditure is non cash costs, with increases in cost of capital and depreciation, and a downward valuation adjustment as new schemes come on to the road network. The reduction in recorded expenditure on major rail projects in part reflects the influence of the regulatory regime. 1 April 2009 is the start of the next five year control period for regulated UK rail activity. In 2008-09 there was a reduction in the major rail projects funded direct by Transport Scotland as the activity of the previous control period wound down. In the latter stages of the old control period, but particularly in the new control period Transport Scotland is making increasing use of Network Rail funding for major projects.

38. At 31 March 2009, Transport Scotland held net assets of £14,764 million, a 2.6% increase from the £14,391 million of the previous year. This largely reflected Scotland's trunk roads network, which, including assets under construction had a net book value of £14,958 million at the balance sheet date, a 2.0% increase from the previous year's £14,665 million. The most significant factor in the movement is usually indexation. In 2008/09 this accounted for £203 million of the net £293 million. In 2007/08 indexation was £1,083 million, but this was unusually high because of higher oil and other commodity prices.

Financial sustainability and budgets for 2009-2011

39. The Scottish Budget Spending Review 2007 (SR07) has set annual spending plans from 2008/09 to 2010/11. The plans are intended to give more focus on long-term outcomes for Scotland and are reviewed annually to cope with changing conditions over the 3 year period. The current annual spending plans for the remaining 2 years of SR07 are:

Resource allocation (£million)	2009/10*	2010/11**
Resource – Operating Costs	863.5	839.3
Resource – Investment	594.1	595.8
Cost of Capital (notional)	595.5	649.1
Total	**2053.1**	**2084.2**
Capital	176.0	212.7
Total	**2,229.1**	**2,296.9**

*** Source- Budget (Scotland) Bill 2009-10**
****Source- SR07**

40. Transport Scotland is expected to achieve 2% of efficiency savings per year over the three year period of Transport Scotland's corporate plan (2008-11). Delivering efficiencies year on year while

absorbing pay inflation and other cost pressures represents a significant challenge for the organisation.

Management and use of ICT

41. As part of our 2008/09 audit we followed up our previous work on the Computer Services Review to determine what progress had made in implementing the agreed actions. We noted that Transport Scotland had made progress in all areas, for example, the information and communications technology (ICT) strategy has now been formalised following consultation with the ICT Steering Group and approval by the board; and various work streams are being progressed in line with the strategy. Also, arrangements are in hand for further development of areas considered in the original review and follow up, for example, an information asset register is being created and managed by the Knowledge Management Team.

National Studies

42. During the 2008/09 audit we followed up the Transport Scotland's response to the Audit Scotland review of major capital projects. In addition, in the period, Audit Scotland published three national studies relevant to Transport Scotland's use of resources. These were use of consultancy services, improving energy efficiency and improving public sector purchasing.

Major capital projects

43. In our report on the 2007/08 audit we drew attention to the publication of the Audit Scotland report on major capital projects (published on 24 June 2008). During 2008/09 the Public Audit Committee of the Scottish Parliament considered this report, taking evidence from Sir John Elvidge, Permanent Secretary and Alyson Stafford, Director of Finance, Scottish Government. The Committee published its report on 19 February 2009, making a number of recommendations and asking that it be kept informed of a number of planned developments. Transport Scotland has a key role in capital projects in Scotland and is represented on the Scottish Government's Infrastructure Investment Group; and will therefore be involved in responding to the Public Audit Committee recommendations.

44. We followed up responses at a more local level, in terms of consideration by Transport Scotland senior management and any changes to procedures. Transport Scotland reported that the recommendations arising from the Audit Scotland report had been considered by individual Directorates and were being more formally considered by the Investment Decision Making Board. In particular, the IDM Board had reviewed the Audit Scotland Good Practice Checklist that had been published in conjunction with the report and considered that it fitted comfortably with the existing processes now followed within Transport Scotland. The IDM Board agreed that the checklist would be cross referenced to the updated IDM Board guidance (April 2009) and other major project guidance to

ensure that all aspects were covered; and that following that review an update would be presented to the IDM Board for agreement on the way forward.

Use of consultancy services

45. The overall aim of the study was to review central government's use consultancy services and to make recommendations to improve the public sector's use of consultants' knowledge, skills and resources to help deliver new services and initiatives quickly and expertly. Transport Scotland was not selected for the case studies examined. However, the report included information on Transport Scotland's expenditure on consultants in 2006/07, which, at £12 million, represented approximately 10% of the total spent by the Scottish Government, its Agencies and NDPBs and one third of the total spent by Agencies themselves. The report made specific recommendations for public bodies to :

- confirm they have clear processes for approving and recording the use of consultants and monitoring progress, and reinforce these as required
- plan their use of consultancy services when developing their forward work programme to ensure that consultants are used where their knowledge and skills bring greatest value for money
- always evaluate the option to use consultants against the option to use their own staff
- gather and share consistent information on the consultancy skills bought and why consultants are used
- improve the quality of their invitations to tender through better and earlier discussion with consultants about their consultancy needs
- increase the use of framework agreements where possible by ensuring that existing agreements are used and new ones developed as appropriate
- select and use the most economical competition routes by using framework agreements, restricted competitions and closed tendering approaches when appropriate
- evaluate the work of consultants more systematically and share findings from these reviews
- work closely with consultants to increase assurance on quality and make use of opportunities to learn from consultants and ensure knowledge transfer, where appropriate.

46. Transport Scotland Finance have recently instigated a significant review of manpower reporting across the agency. This will involve the development of an enhanced forecasting tool, which will clearly identify costs for all staffing categories and for permanent and non-permanent staff. A new, improved suite of reports will be produced which will identify budget, actual and forecasts for each category of staff and these reports will be analysed and presented at each divisions' management

teams on a monthly basis to ensure costs are accurately classified and kept within budget. These reports will be accompanied by monthly payroll reconciliations for each staff category in each division.

Improving energy efficiency

47. Audit Scotland assessed how councils, NHS bodies and central government bodies were improving energy efficiency in relation to buildings and transport use. Transport Scotland was not directly part of the study programme. The study included examination of a range of issues including whether public bodies demonstrate commitment to improving energy efficiency; how public bodies are performing against their objectives and targets for improving energy efficiency; and if public bodies are delivering continuous improvement in this area. The key findings of the report were as follows:

- Funding has been made available by the Scottish Government and public bodies to improve energy efficiency. While energy consumption in buildings has fallen, spending on energy increased in the three years to 2006/07.
- There is a need for stronger leadership by the Scottish Government and within public bodies to improve energy efficiency and ensure that the necessary cultural and behavioural changes are made.
- A robust strategy is central to the coordination of activities to improve energy efficiency, however, there are inconsistencies in the quality of strategies being implemented
- There is a lack of formal monitoring and reporting of progress in improving energy efficiency by public bodies and the Scottish Government.

48. The Transport Scotland Travel Plan, first published in 2008, is used to measure, monitor and minimise the greenhouse gas emissions arising from travel by Transport Scotland employees. The organisation is well on course to meet initial targets of a 5% reduction in rail travel and a 10% reduction in travel by private car by November 2009. It is accepted that more work has to be done in the area of business travel, and whilst the nature of Transports Scotland’s work necessitates travel to and from projects across Scotland, the organisation is re-doubling its efforts to ensure that this is done in the most sustainable way. In addition, Transport Scotland has established a Green Committee whose role is to seek effective ways of reducing the amount of power used and to encourage re-cycling.

Improving public sector purchasing in Scotland

49. Audit Scotland provided a position statement on progress made by the Procurement Reform Programme in implementing the 2006 McClelland report recommendations. The report considered the progress and impact of the Programme, and made specific recommendations for the Scottish Government and for centres of expertise. The report also recommended that, in order to demonstrate Best Value when purchasing goods and services, public bodies should:

- have high-quality purchasing strategies and plans in place, including a plan to meet future workforce needs
- have up-to-date information on their purchasing activities, such as supplier details, volume of transactions, value and type of spend
- ensure all purchasing practices, including control of spending, comply with good practice as set out in national and centres of expertise guidance
- work with the Scottish Government and centres of expertise to identify and develop opportunities for collaboration and for improved purchasing practice
- use BPIs to assess performance and to continually improve how they buy goods and services
- report savings and other benefits on a regular and consistent basis.

50. Transport Scotland keep their procurement policies under review to ensure best value, including budgeting, planning and regular management reporting.

Governance and Accountability

51. High standards of governance and accountability, with effective structures and processes to govern decision-making and balanced reporting of performance to the public, are fundamental features of best value. This section sets out our findings arising from a review of Transport Scotland arrangements.

52. Increasingly services are being delivered across the public sector through partnership working, sometimes involving complex governance and accountability arrangements. Best value characteristics also include effective partnership working to deliver sustained improvements in outcomes.

Overview of arrangements

53. This year we reviewed:

- key systems of internal control
- the developing arrangements for the Concessionary Travel Schemes
- internal audit
- arrangements for the prevention and detection of fraud and irregularity, including standards of conduct.

54. Our overall conclusion is that arrangements within Transport Scotland are sound and have operated through 2008/09. 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 noted 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. In 2008/09 we are pleased to note the further development and consolidation of these arrangements, including the successful implementation of a more centralised finance team.

Systems of internal control

55. 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 their annual report for 2008/09 the Scottish Government Internal Audit Division, Transport Scotland's internal auditors, recorded their

opinion that, based on the internal audit work undertaken during the year, they were able to provide substantial assurance in respect of the Agency's risk management, control and governance arrangements.

56. 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.

57. 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.

58. 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 Travel Schemes

59. In 2006/07 a number of issues arose from our audit of the Concessionary Travel 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 followed up this work, concluding that Transport Scotland had 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 Schemes.

60. In 2008/09 we noted the further development of the control environment, in particular:

- the appointments of a Business Manager and an Operations Manager, in October 2008, being a major step forward in terms of promoting effective team work and sharing of information
- a review and update of the Risk Register and the development of a Fraud Policy

- enhanced performance measurement and management processes, as reflected in the reporting to the governance board.

61. The results of the Review of the Scotland-Wide Free Bus Travel Scheme for Older and Disabled People were published in May 2009. This report included a series of recommendations which are currently being taken forward by the Scottish Government Transport Directorate with input from Transport Scotland. The Smartcard Rollout continues to make progress, with around 66% of the rollout complete at October 2009. The Options Appraisal of the Smartcard Programme is also progressing well, with the report not yet finalised as of October 2009.

Statement on Internal Control

62. The Statement on Internal Control provided by Transport Scotland's Accountable Officer reflected the main findings from both external and internal audit work. This recorded management's responsibility for maintaining a sound system of internal control and set out Transport Scotland's approach to this. The Statement records developments in the internal control environment, including enhanced arrangements for risk management; planned developments for meeting the requirements set out in the Security Policy Framework for the management and control of risks to information; and an update on the Concessionary Travel Schemes. The Statement also makes reference to the Audit Scotland review of the ScotRail Franchise extension, the consideration of this by the Public Audit Committee of the Scottish Parliament and, in particular, the reinforcing of arrangements for registering and managing potential conflicts of interest (see also paragraph 65 below).

63. We are satisfied that the Statement complies with the relevant guidance in the Scottish Public Finance Manual; that the process put in place by the Accountable Officer to obtain assurances on systems of internal control is adequate; and, that the contents of the Statement are not inconsistent with the information arising from our normal audit work. We are content, therefore, that the Statement on Internal Control discloses Transport Scotland's position appropriately.

Internal Audit

64. 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 2008/09 audit we assessed whether we could place reliance on Transport Scotland's internal audit function. We concluded that Scottish Government Internal Audit Division operates in accordance with the Government Internal Audit Manual and therefore placed reliance on their work in number of areas during 2008/09, as we anticipated in our annual audit plan. This included reliance on aspects of internal audit's systems work to avoid duplication of effort.

Arrangements for the prevention and detection of fraud and irregularity, including standards of conduct

65. The Auditor General's report on the First ScotRail passenger rail franchise (November 2008) included consideration of Transport Scotland's procedures relating to declaration of interests. This report, and our previous corporate governance work undertaken as part of the annual audit, confirmed that a register of Board Members' interests is maintained by the Chief Executive's office and is available for public inspection. 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. Transport Scotland have now adopted this good practice, with declarations of interest a standing agenda item for meetings of the Board and the Investment Decision Making Board. In response to some of the issues raised by the rail franchise report the Scottish Government has also made a number of changes to improve processes to prevent potential conflicts of interest. These include more consistent systems for identifying potential conflicts of interest during recruitment and a more systematic process to manage potential conflicts of interest for the senior civil service.

66. Transport Scotland uses the Scottish Government system for maintaining a register of gifts and hospitality. There are no related party transactions disclosed in the notes to the accounts. The Management Commentary section of the annual accounts records that the shareholding in First Group plc of the former Director of Finance of Corporate Services (resigned 28 November 2008) had previously been declared in the Register of Interests and Annual Accounts; and that appropriate additional control practices had been implemented in respect of contract negotiations and other circumstances to confirm there were no conflicts of interest.

Concessionary Travel Schemes fraud policy and irrecoverable debt

67. The Concessionary Travel Scheme Fraud Policy received Ministerial Approval in February 2009. We have reviewed the Fraud Policy, and the supporting Fraud Strategy, and are satisfied that this is a robust framework for dealing with instances of suspected fraud. Transport Scotland is working with other organisations to prevent and detect fraud in the Scheme, for example, the Traffic Commissioner's Office, the police and the Procurators Fiscal.

68. During the year, the Crown Office agreed to work with Transport Scotland on cases where instances of suspected fraud have been reported to the police; and Transport Scotland is instructing solicitors (retained by the Scottish Government) in cases involving civil debt recovery. Note 22 to the accounts records losses of £0.6 million arising from the first three years of the operation of the Scheme. The Scheme obliges Transport Scotland, in the normal course of business, to advance 90% of the anticipated monthly claim of a bus operator. The disclosed losses are the best estimate of the irrecoverable debt arising from overpayments to bus companies that have gone into receivership. Some of the irrecoverable overpayments may relate to fraudulent claims.

Performance

69. 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. Key features of best value include:

- setting a clear vision of what the organisation wants to achieve, backed up by plans and strategies to secure improvement, with resources aligned to support their delivery;
- a performance management culture which is embedded throughout the organisation and a performance management framework which is comprehensive and supports the delivery of improved outcomes.

70. In this section we comment on:

- Transport Scotland's corporate and business plans
- performance against targets
- arrangements for performance management and risk management
- Transport Scotland's efficiency programme
- Relevant National studies, including the First ScotRail Franchise.

Vision and strategic direction

71. Transport Scotland published its Corporate Plan for 2008 – 2011, and the related Business Plan for 2008/09, in September 2008. The 2009/10 Business Plan was published in June 2009. These plans are structured around Transport Scotland's Delivery Priorities and its Working Principles. The Delivery Priorities are firmly focused on the Government's Purpose (increasing sustainable economic growth), its Strategic Objectives (to make Scotland wealthier and fairer; smarter; healthier; safer and stronger; and greener) and many of its National Outcomes. Transport Scotland's Delivery Priorities are:

- Improved connections across Scotland
- Better journey times, better reliability
- Greener transport alternatives, reduced emissions
- Increased safety, more innovation.

72. In addition, the Corporate Plan outlines Transport Scotland's Working Principles. These are summarised as "Strive for excellence in everything we do", but are encapsulated in five core principles:

- Strive to become a centre of excellence in transport delivery, both nationally and internationally
- Promote transport integration
- Maintain a clear outward focus on the needs of transport users
- Work in partnership with other transport providers and wider government in our planning and delivery
- Make the most efficient use of public resources, and equip our staff to do the best possible job.

73. Within each Delivery Priority, and for the Working Principles, Transport Scotland has set proposed key deliveries or actions along with timescales. Transport Scotland identifies tasks and targets within its annual Business Plan that contribute to achievement of the Corporate Plan Priorities; and keeps these tasks and targets under review to monitor their achievements

Performance overview

74. Transport Scotland's Annual Report for 2008/09 records the delivery of 12 key achievements as per the table below.

Transport Scotland Business Plan Outturn Report on Key Achievements for 2008/09

Target	Delivery
The Strategic Transport Projects Review	Dec 08
A procurement strategy for the Forth Replacement Crossing	Nov 08
The new Stirling-Alloa-Kincardine rail link	May 08
A new double-track railway between Bathgate and Edinburgh, the first stage of the Airdrie-Bathgate project	Oct 08
Reduced rail journey times from Edinburgh to Aberdeen	Dec 08
Extra seats for Fife rail commuters	Dec 08
Continued growth in rail passenger numbers	3.2% growth
The start of construction on M74 and M80 completion	May 08, Jan 09
The Upper Forth Crossing at Kincardine and the Dalkeith Bypass	Nov 08, Sep 08
Better analysis of the environmental impact of major transport projects	Mar 09
21% of energy on trunk road network from renewable sources	Achieved
2% efficiency gains amounting to over £30m	£40m delivered

75. A more detailed record of progress against each Business Priority, in terms of its component targets, is also provided in the annual report. Most of the targets which were planned to be achieved in 2008/09 were achieved, with some recorded as partly achieved, some as ongoing and one deferred. The target deferred was to establish and run the Scottish Bus Service Operator Grant scheme from 1 April 2009; the target is now to take on responsibility for this from 1 April 2010.

76. A brief summary and commentary on the achievement of targets by Business Priority is provided below.

Summary progress against 2008/09 targets by Business Priority

Business Priority	Commentary on achievement of targets
Improved connections across Scotland	9 targets were rated as achieved, with 4 partly achieved and 1 on-going.
Better journey times, better reliability	6 targets were rated as achieved, with 2 partly achieved and 2 ongoing.
Greener transport alternatives, reduced emissions	11 targets were rated as achieved, with 1 partly achieved.
Increased safety, more innovation.	4 targets were rated as achieved, with 1 as ongoing, 1 as partly achieved and 1 as deferred.
Strive for excellence in everything we do	11 targets were rated as achieved, with 1 assessed as ongoing.

Performance management

77. The Transport Scotland Board regularly reviews performance against the business plan through the monthly board pack, discussing progress and taking appropriate action to resolve any issues arising.

78. The delivery of the corporate plan objectives will be challenging given the tight financial constraints over the same period. This is an area we will keep under review during our appointment.

Risk management

79. Many Transport Scotland staff have been managing major projects and operating in a culture of risk management for many years. Since its inception Transport Scotland has built on the risk management arrangements inherited from the Scottish Government embedding these into the activities and functions at both a Directorate and corporate level. Practice at Directorate level will vary according to circumstance, but, for example, significant projects will have their own risk register; Directorates will consider their risk registers at monthly Directorate board meetings and sometimes more frequently at less formal meetings of management; and the Corporate Risk Register has been part of the monthly Board pack and formally considered at each Board meeting. Also, the Audit Committee has a role in overseeing risk management arrangements

80. During 2008/09, to further strengthen arrangements, Transport Scotland formalised a high-level Risk Strategy setting out a consistent approach to the implementation of risk management within Transport Scotland at strategic, programme and project levels; and established a Risk Management Committee, which is responsible for developing a Risk Framework, for maintaining the Corporate Risk Register and for facilitating the production and management of risk registers within project teams and Directorates on an appropriate and consistent basis. The Risk Committee consists of the functional

directors accompanied by at least one risk champion from their Directorate. The Risk Committee will report formally to the Board on a quarterly basis.

Efficiency

81. Transport Scotland has been expected to achieve 2% of efficiency savings per year. This translated into a target of £30 million for 2008/09, with Transport Scotland recording in their Annual Report achieved efficiencies of £40 million through more competitive prices for trunk road management and maintenance; negotiating savings on the Airdrie-Bathgate rail project; and by obtaining a more efficient level of grant funding to Network Rail. Over the three year period of Transport Scotland's corporate plan (2008-11), Scottish Ministers have set a target of delivering efficiency savings in excess of £150 million. In Transport Scotland's business plan for 2009/10 the Agency's target is to achieve savings of at least £50 million.

82. We will continue to monitor the financial position and the actions taken by Transport Scotland to manage these risks.

National Studies

The First ScotRail passenger rail franchise

83. The Audit Scotland report on the First ScotRail franchise was published on 28 November 2008. The report examines the management of the franchise and reviews the process for awarding the extension to the franchise. The Report also assesses First ScotRail's performance.

84. Key messages arising out of the report were as follows:

- First ScotRail will receive £2.5 billion in government subsidy for the franchise over its ten-year term
- Transport Scotland is generally managing the franchise contract effectively, but there is some scope to improve
- Information about the franchise contract and associated performance is not readily accessible to passengers, user groups and others
- Transport Scotland's review of the franchise contract included a rigorous appraisal process, and it has secured a guaranteed £73.1 million investment by First ScotRail. However, governance arrangements could have been better managed
- First ScotRail's train running and quality of service is good and performance is improving in most areas.

85. The report made a number of recommendations to Transport Scotland, both in terms of improving its management of the franchise, and improving stakeholder understanding, transparency and accountability.

86. The Public Audit Committee held several sessions on the First ScotRail franchise report taking evidence from a range of witnesses. They published their report on 11 June 2009, making a number of recommendations on the management of the franchise. The Public Audit Committee also considered the role of the former Director of Finance and Corporate Services and the circumstances of his resignation, again making a number of recommendations and also concluding that they were not satisfied that they had received all the information that they required to address all the issues that were of concern to them. We have considered this aspect in other relevant sections of this report.

Looking Forward

87. Transport Scotland faces a number of challenges in 2009/10, which include:

- **National Performance Framework** - The Scottish Government is continuing to develop its approach to performance management based on the National Performance Framework and local authority single outcome agreements. The National Performance Framework is an outcome-based approach that is publically reported on the Scottish Government's web site in the 'Virginia-style' model of performance measurement and reporting. 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. Transport Scotland corporate planning and reporting is aligned with the National Performance Framework; and we will follow developments in this area as part of the 2009/10 audit.

- **Delivery, future funding and efficiencies** – Within the overall, established planning and reporting framework as per above, Transport Scotland's corporate plan 2008-11 and business plan for 2009/10 identify the major projects and other priorities to be delivered in the period. Going forward, priorities will need to be delivered within a tighter funding regime, for example, for the Scottish Government: there is no scope for the application of end of year flexibility until the next Spending Review; no option to transfer funds from capital to revenue; and the need to accommodate the impact of the introduction of International Financial Reporting Standards (IFRS), particularly on leases and infrastructure accounting. This creates challenges for Transport Scotland, working with colleagues in Scottish Government, in terms of managing budgets within year, prioritising spending, identifying efficiencies and reviewing future commitments to ensure delivery of key targets and objectives.

- **IFRS** - The timetable for IFRS implementation requires central government accounts in Scotland to become IFRS compliant with effect from the 2009/10 financial year. As part of the timetable for the implementation for IFRS, Transport Scotland were required to prepare shadow accounts by 30 September to allow consolidated Scottish Government accounts to be prepared in December and to allow audit review. The introduction of IFRS results in significant changes to budgeting and accounting in relation to PFI schemes and other aspects of roads accounting. Although there has been preparatory work on the impact of IFRS, it is important that this exercise continues to be resourced appropriately and that timetables are met.

- **Corporate developments, including data handling** – We welcome the proposed continuing developments in improving business processes and will monitor progress on these. In particular, in 2009/10 Audit Scotland is planning to follow up developments in data handling arrangements across its clients. The Scottish Government carried out a review of data handling arrangements in Scotland 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 improved security of sensitive information and this will be the benchmark against which we will assess progress.

Appendix A: Action Plan

Key Issues/ Risk Areas and Planned Management Action

Action Point	Issue/ risk Identified	Planned Action	Responsible Officer	Target Date
1 Report para 21	**Compulsory purchase of land** Existing arrangements for monitoring the position on the compulsory purchase of land, involving reliance on the Valuation Office Agency, resulted in an underestimate of the likely costs. *We recommend that a more detailed record of the compulsory purchase transactions that would most influence the value of the provision is kept; and that consideration be given to incorporating VAT in the values included in the provision in relation to compensation payable to commercial organisations.*	We agree that selective monitoring of key transactions to allow a more accurate financial estimate of the provision for compulsory purchase of land would help improve the accuracy of the accounts; and would be an appropriate supplement to the detailed records maintained by the Valuation Office Agency.	Ross Williamson	In process