

Transport Scotland

Annual report on the 2011/12 audit



Prepared for Transport Scotland and the Auditor General for Scotland
September 2012

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. It provides services to the Auditor General for Scotland and the Accounts Commission. Together they ensure that the Scottish Government and public sector bodies in Scotland are held to account for the proper, efficient and effective use of public funds.

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Key messages

2011/12

We have given an unqualified audit report on the financial statements for 2011/12. The audited accounts do not include any adjustment for the element of depreciation on the revalued roads balance. As a result of this, we estimate that the revaluation reserve was overstated by £52m. The omission is not currently material and Transport Scotland has agreed to review the issue for 2012/13.

Overall outturn of £2,055 million was £36 million (1.7%) below budget with the underspend attributed to capital underspends on the Forth Replacement Crossing and lower than expected final costs on the completion of the M74 extension.

Transport Scotland ("the agency") is responsible for delivering a number of key Scottish infrastructure projects, the nature and scale of these projects brings associated financial risks. The projects include cost adjustments for financial risk. We plan to prepare a watching brief on major infrastructure projects later this year.

Transport Scotland is also responsible for renewing the current ScotRail franchise and funding arrangements for Network Rail. This represents 38% of Transport Scotland's expenditure and the renewal of contract arrangements in 2014 within an affordable envelope is a significant element of the financial position going forward.

The Transport Scotland management board does not include non-executive members. The reasons for this are founded on the direct accountability of ministers for the activities of Transport Scotland as an integral part of the Scottish Government. This might suggest one area where a traditional board arrangement would provide additional governance: as a check or balance against ministerial policy which is clearly unachievable or unfunded. Setting this aside, our current view is that the existing governance arrangements would appear to be addressing many of the perceived areas of weakness. Audit Scotland is currently undertaking a follow up review of the role of boards in Scottish Public Bodies and we will further review the arrangements in light of the findings and any response to this by the Scottish Government.

Outlook

Excluding £277 million of non-recurring capital expenditure on PFI schemes in 2011/12, the 2012/13 budget shows an increase of £98.6 million (5.5%) in nominal terms compared to 2011/12. This upward trend in budgets is expected to continue for the following two years to the end of the current spending review period in 2015.

Despite the increasing level of resources available to Transport Scotland over the coming three years, the agency will face challenges in balancing the need to deliver the Scottish Government's programme of major transport infrastructure projects with the demands of on-going maintenance of the existing transport network.

Introduction

1. This report is the summary of our findings arising from the 2011/12 audit of Transport Scotland. The purpose of the annual audit report is to set out concisely the scope, nature and extent of the audit, and to summarise the auditor's opinions (i.e. on the financial statements) and conclusions and any significant issues arising. The report is divided into sections which reflect the extent of our public sector audit model.
2. A number of reports have been issued in the course of the year in which we make recommendations for improvements (Appendix A). We do not repeat all of the findings in this report, but instead we focus on the financial statements and any significant findings from our wider review of key control systems and work on governance arrangements.
3. Appendix B is an action plan setting out the high level risks we have identified from the audit. Management have considered the issues and agreed to take the specific steps in the column headed 'planned management action'. We do not expect all risks to be eliminated or even minimised. What we expect is that Transport Scotland understands its risks and has arrangements in place to manage these risks. The Accountable Officer (Chief Executive) and management board should ensure that they are satisfied with the proposed management action and have a mechanism in place to assess progress.
4. This report is addressed to Transport Scotland and the Auditor General and should form a key part of discussions with the Audit and Risk Committee. Reports should be made available to stakeholders and the public, where appropriate. Audit is an essential element of accountability and the process of public reporting.
5. This report will be published on our website after consideration by the Audit and Risk Committee and after the financial statements have been laid before parliament.
6. The management of Transport Scotland is responsible for preparing financial statements that show a true and fair view and for implementing appropriate internal control systems. Weaknesses or risks identified by auditors are only those which have come to our attention during our normal audit work, and may not be all that exist. Communication by auditors of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

Financial statements

7. Audited bodies' financial statements are an essential part of accounting for their stewardship of the resources made available to them and their performance in the use of those resources.
8. We are required to audit financial statements in accordance with the timescales set by Audit Scotland, which may be shorter than statutory requirements, and give an opinion on:
 - whether they give a true and fair view of the financial position of audited bodies and their expenditure and income
 - whether they have been properly prepared in accordance with relevant legislation, the applicable accounting framework and other reporting requirements
 - the regularity of the expenditure and income.
9. We review and report on, as appropriate, other information published with the financial statements, including the management commentary, governance statement and the remuneration report. We also review and report on the Scottish Government Consolidation Pack incorporating the Whole of Government Accounts return. This section summarises the results of our audit on the financial statements.

Audit opinions

10. We have given an unqualified opinion that the financial statements of Transport Scotland for 2011/12 give a true and fair view of the state of the agency's affairs and its net operating cost for the year.
11. Transport Scotland is required to follow the 2011/12 Government Financial Reporting Manual (the FReM) and we confirmed that the financial statements have been properly prepared in accordance with the FReM. We also confirmed that relevant parts of the remuneration report had been properly prepared and that information given in the management commentary was consistent with the financial statements.
12. We reviewed the Governance Statement and concluded that it complied with Scottish Government guidance.
13. Transport Scotland provided us with their unaudited Scottish Government consolidation pack on 12 July 2012. The deadline for the submission of the audited pack was 13 July. We were able to submit the audited consolidation pack to the Scottish Government on 19 July 2012. We found no significant errors in the consolidation pack or the incorporated WGA return.

Regularity

14. In accordance with the requirements of the Public Finance and Accountability (Scotland) Act 2000, we have also provided an opinion that in all material respects, the expenditure and receipts in the financial statements were incurred or applied in accordance with applicable enactments and guidance.

Accounting issues

Accounts submission

15. We received the unaudited accounts on 15 May 2012, in accordance with the agreed timetable. However, the financial statements and supporting notes were not substantially complete until 12 June 2012. The initial submission did not include inter-government and comparative information, statement of Chief Executive's responsibilities, management commentary, remuneration report and financial information for related parties (including Highlands & Islands Airports Ltd, Caledonian Maritime Assets Ltd, and David MacBrayne Ltd).
16. We recommend that a revised timetable for 2012/13 is developed, based on a later, more complete submission for audit. We believe that this will help to contribute to efficiencies in the audit process over time.

Refer action plan point 1

17. Throughout the process Transport Scotland staff provided good support to the audit team and we completed our on-site fieldwork on 19 July 2012, with follow-up as required by our staff during the week beginning 23 July 2012.
18. There were no significant monetary adjustments made to the main financial statements as a result of the audit. There were some immaterial unadjusted errors which were detailed in our ISA 260 report presented to the Audit and Risk Committee on 30 July 2012. The most significant of these are described in paragraph 20 below.

Prior year adjustments

19. There was one change to the accounting framework (FReM) in 2011/12, which has been reflected in the financial statements as a prior period adjustment. The change was that grants received in respect of non-current assets are now recognised as income immediately, unless there is a condition that the recipient has not satisfied that would lead to grant repayment. Most such grants should therefore now be recognised as income so the government grant reserve and donated asset reserve no longer exist. The agency implemented this required change in accounting policy appropriately. As a result the donated asset reserve of £0.8 million was removed and the balance transferred to the General Fund.

Other Issues

20. **Roads depreciation and adjustment to revaluation reserve** - The financial statements omit an adjustment in the statement of change in taxpayers' equity (SoCTE) for the element of depreciation which relates to the revaluation of the road network to be released from the revaluation reserve to the general fund. This transaction has not been disclosed for the last two years. Without this adjustment the revaluation reserve would never reflect the decrease due to depreciation on the revalued element of the road network. As the revaluation fund is 48% of total assets and depreciation is £63 million, we would have expected a sizeable transfer of around £30 million in 2011/12 (and estimated to be £22 million in 2010/11) from the revaluation reserve to the general fund. We estimate that the revaluation reserve is overstated

by £52 million with an understatement in the general fund of a similar amount. These are misstatements between the reserves only and do not affect other parts of the financial statements. The materiality of this error is likely to increase over time and the issue is likely to become material in 4 years, taken in the context of the overall roads valuation and reserve balances. While we accept that the misstatement is not currently material, we expect the issue to be reviewed by Transport Scotland in 2012/13 and agreement to be reached over a method for determining this transaction in future financial statements.

Refer action plan point 2

21. Roads network valuation - There was a difference of £46 million in the opening balance for the roads network valuation, compared to the previous year's closing amount. The difference was calculated by WS Atkins LLP as part of their annual valuation process, and relates to measurement errors identified in the former valuer's report. Transport Scotland chose not to account for this under International Accounting Standard 8 as a prior period error on the grounds of materiality, but reflected the change in the historic adjustments line in the non-current assets note in the financial statements. We accepted that the error was not material (again in the context of the overall roads valuation) and that adjustment in the current financial year was appropriate.

22. M80 Steps to Haggs private finance initiative (PFI) - As part of our financial statements audit we reviewed the analysis of charges and balances for the M80 Steps to Haggs PFI project. These transactions were included in the financial statements for the first time in 2011/12, as the unitary charges for the project commenced in September 2011. We found that the capital costs were consistent with the bidder's financial model, but identified an error in the calculated interest rate applied. A discount rate of 6.09% had been used to determine the interest element rather than the interest rate inherent in the bidder's model of 6.45%. We did not consider the error to be material, but recommend that this should be corrected in 2012/13, and that other PFI schemes should be reviewed in case of similar errors.

Refer action plan point 3

23. Reporting outturn. Transport Scotland's outturn of £2,055 million against the Scottish Government's budget for 2011/12 is set out in the management commentary. The statement of comprehensive net expenditure identifies net operating costs of £1,557 million. We consider that the disclosures in the management commentary could be further improved with the inclusion of a reconciliation of outturn to net expenditure. Table 1 overleaf identifies how these two amounts can be reconciled.

Refer action plan point 4

Table 1: Reconciliation of Net Operating Expenditure to Outturn

	£m
Net operating costs per SoCNE	1,557
- AME capital (release of provisions)	(5)
+ DEL capital not recognised in SoCNE as in year expenditure	225
+ ODEL capital (expenditure on PFI schemes) not recognised in SoCNE as in year expenditure	278
Outturn per management commentary	2,055

Outlook

Sustainability Reporting

24. From 2011/12, all relevant bodies were encouraged to produce a sustainability report in accordance with the Scottish Government's Public Sector Sustainability Reporting Guidance (January 2012). This guidance is non-mandatory, however it represents good practice and central government bodies were encouraged to adhere to it. The sustainability report should contain:
- a simple overview commentary covering a body's performance in the reported year along with an overview of forward plans
 - a table of financial and non-financial information covering the body's emissions, waste, water and any other finite-resource consumption for the financial year to which it relates.
25. Public bodies in Scotland are bound by the Climate Change Public Bodies Duties set out in Part 4 of the Climate Change (Scotland) Act 2009. Whilst the Act does not require reporting on the duties, appropriate sustainability reporting may assist public bodies to demonstrate compliance with the climate change duties and the Public Bodies Duties Guidance encourages a voluntary approach to reporting.
26. Transport Scotland has not included a sustainability report in the 2011/12 financial statements. However, management have advised that sustainability information covering 2010/11 and 2011/12 will be published separately in line with the Public Services Reform Act. This information is expected to be published in October 2012. As this report was not included as part of the Annual Report and Accounts it is not covered by the consistency element of our audit opinion.
27. We recommend that management consider the inclusion of a sustainability report in line with Scottish Government guidance in the 2012/13 financial statements.

Refer action plan point 5

Financial position

28. Audited bodies are responsible for conducting their affairs and for putting in place proper arrangements to ensure that their financial position is soundly based.
29. We consider whether they have established adequate arrangements and examine:
 - financial performance in the period under audit
 - compliance with any statutory financial requirements and financial targets
 - ability to meet known or contingent, statutory and other financial obligations
 - responses to developments which may have an impact on the financial position
 - financial plans for future periods.
30. These are key areas in the current economic circumstances. This section summarises the financial position and outlook for the organisation.

Financial results

Annual outturn

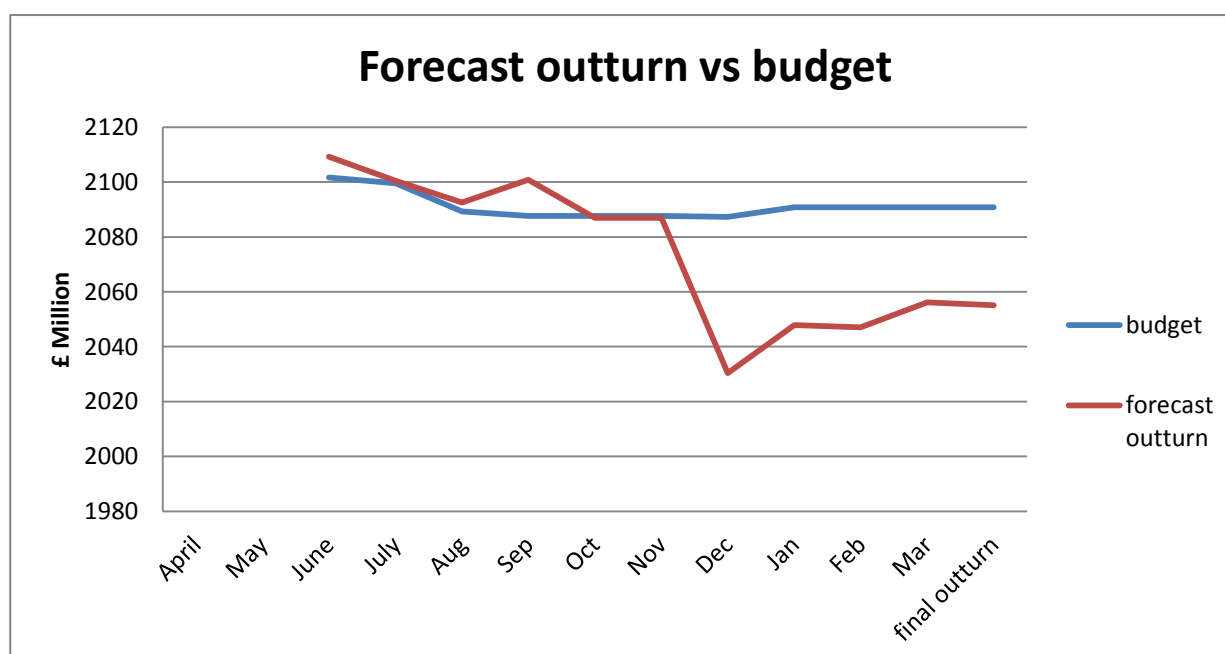
31. The statement of comprehensive net expenditure for financial year 2011/12 shows net operating costs of £1,557 million. Overall outturn of £2,055 million was £36 million (1.7%) below budget with the underspend attributed to capital.
32. Scottish Ministers allocated £2,091 million of resources to Transport Scotland for 2011/12. The significant in-year budget revisions included a reduction of £7 million (Annually Managed Expenditure (AME)) in provisions for land compensation and damage claims (for the trunk roads network) and an increase of £276 million for the capital value of new on-balance sheet PFI/PPP projects (M80). UK Government spending movements, via the Barnett formula, generated additional funding of £5 million, which Scottish Ministers allocated for sustainable and active travel and roads maintenance. These budgetary changes are shown in Table 2 overleaf:

Table 2: 2011/12 Outturn against budget

	Initial Budget (£m)	Autumn Revision (£m)	Spring Revision (£m)	Barnett changes (£m)	Final Budget (£m)	Actual Outturn (£m)	Under/ (Over) (£m)
Resource DEL	1,397.6	(14.2)	2.5	4.6	1,390.5	1,442.7	(52.2)
Capital DEL	294.6	3	(1.4)	0.5	296.7	224.6	72.1
non-cash DEL	80.6	-	-	-	80.6	62.5	18.1
Total DEL	1,772.8	(11.2)	1.1	5.1	1,767.8	1,729.8	38.0
Resource ODEL	55.2	-	(2.3)	-	52.9	53.6	(0.7)
Capital ODEL	-	276.7	0.3	-	277.0	276.7	0.3
Capital AME	-	-	(6.8)	-	(6.8)	(5.0)	(1.8)
Overall Total	1,828.0	265.5	(7.7)	5.1	2,090.9	2,055.1	35.8

Source: Transport Scotland Outturn Monitoring Reports

33. The Director of Finance produces budget reports which are scrutinised monthly by the Senior Management team and quarterly by the Audit and Risk Committee. The development of the final outturn position from June 2011 as set out by these reports is shown in Table 3 below (no budget monitoring information is available for April or May 2011).

Table 3: Forecast outturn and budget during 2011/12

Source: Transport Scotland budget monitoring reports

34. The £56 million fall in forecast outturn between November and December 2011 is due to a revised roads condition variance (depreciation) forecast and lower than expected expenditure on roads capital maintenance. The monthly reports proved to be a reliable indicator of final outturn once these mid-year adjustments were taken into account.
35. Within the total underspend against budget, there are elements of significant variance, with the Resource DEL (Departmental Expenditure Limit) budget being overspent by £52 million. The Resource DEL overspend is attributed to the revised payment agreement for the Edinburgh Trams Project (£42.5 million); renovation costs for the Glasgow Subway (£15 million); and increased support for ferry services (mainly for increased fuel costs of £12 million); offset by below budget expenditure on major rail projects (£21 million).

Financial position

36. On the basis of the information in this section of the report, we have concluded that, subject to significant changes in Scottish Government funding and the management of risks and cost pressures associated with significant elements of future expenditure, the financial position of Transport Scotland is stable and its activities are financially sustainable. Transport Scotland is an executive agency of the Scottish Government and receives almost all of its funding from the Scottish Government.
37. The Statement of Financial Position at 31 March 2012 shows net assets of £16.9 billion (31 March 2011: £16.2 billion). As in previous years, this position is largely attributable to the trunk road network which is subject to an annual valuation process. Excluding these non-current assets, the agency has a net liability position of £225 million. Most of this is represented by longer-term liabilities. These increased during 2011/12 due to the completion of the M80 PFI project and recognition of the long term liability connected with this of £271 million.
38. Transport Scotland is responsible for delivering a number of key Scottish infrastructure projects, the nature and scale of these projects brings associated financial risks, some of which can't be fully mitigated through contract terms with suppliers. This includes financial risks due to project delay with complex, unusual, technical or unknown aspects of major construction projects. For example the caisson placement associated with the new Forth Replacement Crossing, ground conditions associated with M8 improvements and planning delays on major projects.
39. Transport Scotland is also responsible for renewing the current ScotRail franchise and funding arrangements for Network Rail. This represents 38% of the agency's expenditure and the renewal of contract arrangements in 2014 within an affordable envelope is a significant element of the financial position going forward.

Concessionary Travel Scheme expenditure

40. In-year forecasting showed that the level of reimbursement claimed by bus operating companies for the Older Persons National Concessionary Travel Scheme would exceed the 2011/12 budget for this part of the scheme, by £10 million. In order to ensure that the budget was not exceeded, payments to operators were reduced on a pro rata basis in the final claim

period. This same measure was taken in two previous years where total reimbursements claims were forecast to be in excess of the budget.

41. Transport Scotland consulted extensively with the Confederation of Passenger Transport (UK) throughout the year to ensure that operators were aware of the likely reduction in payments at an early stage.

Capital investment and performance 2011/12

42. The final 2011/12 capital DEL budget was £0.3 billion. This is an increase of £46 million (18.5%) compared to the previous year. As noted at para 31 above, there was a significant underspend against the capital DEL budget. This underspend is due to:
 - a £50 million prepayment on the Forth Replacement Crossing Project. Management have advised that the resultant underspend accounted for on this project offset the increased payments required under the revised terms of the Edinburgh Trams project. This effectively amounts to a transfer from the DEL Direct Capital budget to the DEL Indirect Capital (Net Investment) budget. We have been further advised that the offset was agreed by Scottish Government finance but was not reported as a budgetary transfer as the budget is not ring-fenced and so only overall expenditure is scored against the budget
 - lower than expected capital expenditure on the M74 extension project due to this project being completed at a lower cost than was anticipated at the beginning of 2011/12.
43. There were no significant capital receipts in 2011/12.
44. In addition to the capital DEL budget, which is used for expenditure related to assets which will ultimately be shown on the Statement of Financial Position (SoFP), the agency provides funding for other capital works where the associated assets will not be shown in their own financial statements. An example of this is Transport Scotland capital expenditure on rail projects, where the resultant infrastructure assets are shown on the SoFP of Network Rail. Such expenditure is included in the Transport Scotland net operating cost for the year.
45. We are currently conducting a review of Transport Scotland's major capital projects. This "watching brief" will provide baseline figures for future assessment of the delivery of these projects against cost and time budgets and report any significant assumptions used within the total cost estimates, for example for inflation and risk. The watching brief is planned to be completed towards the end of the year.

Financial planning to support priority setting and cost reductions

2012/13 budget and reporting

46. The Transport Scotland budget for 2012/13 shows an overall reduction of £198 million (9.5%) compared to 2011/12, but this is due to the 2011/12 budget including one-off ODEL (Outwith Departmental Expenditure Limit) funding of £297 million following completion of the M80 project. Excluding this expenditure from the 2011/12 budget shows an overall budget increase

of £99 million (5.5%), with the main areas of increase in rail services and motorways and trunk roads projects.

47. Additional financial pressures expected in 2012/13 include:

- winter roads maintenance requirements
- the cap on concessionary travel scheme expenditure.

48. As at the end of June 2012, Transport Scotland forecast an overall overspend of £7.0 million against the 2012/13 budget. This is attributed to winter and other weather-related roads maintenance costs and to the Roads Equivalent Tariff ferry pricing scheme.

Workforce reduction and workforce planning

49. During 2011/12, 18 staff in Transport Scotland accepted voluntary exit under the Civil Service Compensation Scheme rules. Details of the cost of these exit packages are shown in the 2011/12 annual report and accounts.

50. Workforce planning at Transport Scotland is the responsibility of the senior management team. Workforce planning discussions are informed by on-going monitoring of the organisational staffing profile and staffing trends carried out by Human Resources. Workforce planning decisions are taken within the overall framework of the Scottish Government's organisational reform and transformation programme (Workforce 2015) and overall staffing strategy.

Asset Management

51. Transport Scotland's main asset is the trunk road network. A general indication of the condition of the network is provided by the in-year depreciation charge, which is calculated from a measurement of the deterioration of the road surface condition during the year.

52. The year on year variation in the roads depreciation charge in the context of the average gross book value (GBV) of the trunk road network and annual expenditure on roads maintenance is shown in Table 4 overleaf:

Table 4: roads depreciation as a proportion of roads value (GBV)

Year	Average roads gross book value (£m)	Roads depreciation (£m)	Depreciation / average GBV	Roads maintenance expenditure at 2011 prices ² (£m)
2011/12	19,304	63	0.33%	155
2010/11	17,858	43	0.24%	222
2009/10	17,052	92	0.54%	213
2008/09	16,571	30	0.18%	281
2007/08	15,750	12	0.08%	317

2 - deflated figures based on resource cost of roads construction index figures published by the Department for Business Innovation and Skills

Source: *Transport Scotland annual accounts 2007/08 to 2011/12*

53. The 2010 Scottish Road Maintenance Condition Survey showed that the proportion of trunk roads in an acceptable condition fell from 84% in 2006 to 78% in 2010. Further deterioration in the condition of the trunk road network since 2010 is due to the severe winter of 2010/11, which would have been picked up through measurements of the road condition in summer 2011 and included in the 2011/12 depreciation charge. This deterioration is consistent with the fall in real terms road maintenance expenditure over the period examined. Despite this, the in year depreciation charge for each of the years examined is very small as a proportion of roads GBV, indicating that deterioration as a proportion of useful life is insignificant.
54. Roads maintenance resource budgets are expected to continue to fall over the coming years. Transport Scotland should continue to monitor budgets in the context of condition assessment of the trunk road network and liaise with Scottish Ministers regarding the likely impact of spending decisions on road condition.

Outlook

Financial forecasts beyond 2012/13

55. The 2012-15 Corporate Plan contains a three year financial summary outlining the planned expenditure, in nominal terms, across each major expenditure area as detailed in Table 5 overleaf.

Table 5: Future Spending Plans

	2012/13 Budget (£m)	2013/14 Spending Plans (£m)	2014/15 Spending Plans (£m)
Rail Services in Scotland	741.1	798.2	817.6
Concessionary Fares	192.8	192.8	192.8
Smartcard	2.0	2.0	2.0
Bus Service Operator's Grant	53.8	53.8	53.8
Major Public Transport Projects	14.8	14.4	8.7
Trunk Roads Maintenance	239.7	239.7	242.7
Motorways and Trunk Roads	325.9	390.9	438.8
Ferry Services in Scotland	107.1	109.0	114.7
Air Services in Scotland	34.5	30.4	30.5
Freight and Canals	11.1	11.1	11.1
Transport Policy	56.1	66.1	55.1
Strategic Project Rvw and Agency Adm.	21.3	20.9	20.5
Forth and Tay Bridge maintenance	18.0	11.2	11.8
PFI/PPP Expenditure	74.5	76.8	84.7
Total	1,892.7	2,017.3	2,084.8

Source: Transport Scotland 2012-15 Corporate Plan

56. These figures are based on information included in the 2011 Scottish Spending Review but include additional capital spending of approximately £85m intended to fund roads projects and sustainable and active travel.
57. The overall increase of £192m (10%) in planned expenditure over the coming two years is represented by "rail services in Scotland" (payments to Network Rail and Scotrail) and "motorways and trunk roads" (roads projects including M8 improvements and the Aberdeen Western Peripheral Route).

Governance and accountability

58. The three fundamental principles of corporate governance – openness, integrity and accountability – apply to all audited bodies, whether their members are elected or appointed, or whether they comprise groups of people or an individual accountable officer.
59. Through its chief executive or accountable officer, each body is responsible for establishing arrangements for ensuring the proper conduct of its affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Audited bodies usually involve those charged with governance (including audit committees or similar groups) in monitoring these arrangements.
60. Consistent with the wider scope of public audit, we have a responsibility to review and report on audited bodies' corporate governance arrangements as they relate to:
- corporate governance and systems of internal control
 - the prevention and detection of fraud and irregularity
 - standards of conduct and arrangements for the prevention and detection of corruption.
61. In this part of the report we comment on key areas of governance.

Corporate governance

Overall effectiveness

62. The following paragraphs identify areas for improvement in some aspects of the corporate governance and internal control arrangements, but with the exception of these we found that overall corporate governance arrangements in place at the agency during 2011/12 were satisfactory.

Processes and committees

63. Transport Scotland changed its management board structure during the previous financial year (2010/11), removing the non-executives members from the board. A note from the accountable officer (to the cabinet secretary for finance and sustainable growth and the minister for transport, infrastructure and climate change), in January 2011, identified a view that "the board provides limited added value ... in going forward, ... we retain our direct accountability to ministers ... at the same time we want to minimise the administrative burdens (and costs). Given the full authority ministers have over our policy and functions, the limited scope for creative challenge or influence from non-executive directors is understandable".
64. Our previous year's audit report commented that "while we appreciate this reflects the primacy of the Scottish Ministers in decisions on Transport Scotland activity, and the level of scrutiny they apply to Transport Scotland's performance, it is our view that this change reduces the

potential for independent advice and challenge to areas such as the monitoring of risk and performance management."

65. We are not aware of any further guidance or clarification of general direction on the role of boards in an executive agency issued by the Scottish Government in response to the Audit Scotland national report on the Role of Boards. However, we have some observations on the operation of the existing arrangements, which are set out below:
- Day-to-day governance of the agency is provided by the Senior Management Team, comprised of the executive directors. This Team meets monthly to discuss relevant issues. Minutes of these meetings are available to the public via the website.
 - Oversight of corporate governance, risk management and internal control is provided by the audit and risk committee (ARC), which comprises three external members and reports to the Chief Executive as Accountable Officer.
 - Although it does seek to limit its activities to those typical of an audit committee, the ARC covers some of the areas that might otherwise be dealt with by a full board / non-executive role. This includes seeking verbal assurances from the Chief Executive for performance management and receiving the Finance Director's report on forecast out-turn and budget.
 - Each major infrastructure project has an overseeing project board with responsibility for authorisation of project changes; oversight and review of the costs, progress and risks and with ensuring adherence to the scope/ objectives and for gateway reviews.
 - The membership of a project board comprises the Chief Executives and other senior executive staff from Transport Scotland and any partnership organisations, as required, and includes the director of the relevant directorate within the agency.
66. The reasons for the existing arrangements are founded on the direct accountability of ministers for the activities of Transport Scotland as an integral part of the Scottish Government. This might suggest the one area where a traditional board arrangement would provide additional governance: as a check or balance against ministerial policy which is clearly unachievable or unfunded. Setting this aside, our current view is that the existing governance arrangements would appear to be addressing many of the perceived areas of weakness.
67. Audit Scotland is currently undertaking a follow up review of the role of boards in Scottish Public Bodies and we will further review governance arrangements in place in light of the findings of the follow-up and any response to this by the Scottish Government.

Internal control

68. While auditors concentrate on significant systems and key controls in support of the opinion on the financial statements, their wider responsibilities require them to consider the financial systems and controls of audited bodies as a whole. However, the extent of this work should also be informed by their assessment of risk and the activities of internal audit.
69. As part of our risk assessment and planning process we assessed the Scottish Government Internal Audit Division, Transport Scotland's internal auditors, and concluded that they operate

in accordance with the Government Internal Audit Manual. The programme of work carried out by internal audit in 2011/12 did not correspond to the agency's key financial systems and as such we did not place assurance on this work.

70. Our audit approach includes a review of the high level controls operating within the agency's key financial systems. Our work on these local systems and controls covered budgetary control, the local aspects of payroll systems and accounts payable, and the main areas of the agency's expenditure. In the interests of an efficient audit approach we also rely on assurances received from the external auditor of the Scottish Government on work performed on shared systems, hosted by the Scottish Government, that operate in respect of the agency. This approach ensures we are delivering an efficient co-ordinated audit that avoids unnecessary duplication and expense.
71. Overall the localised systems of internal control were operating effectively, however our testing did identify a small number of control weaknesses. Our approach to the financial statements audit was amended to reflect the identified control weaknesses.
72. The main weaknesses that we identified were:
 - Journal approval: the overnight SEAS process automatically posts those journals which have not been approved during the previous day. These posted journals are therefore not approved within the ledger system. We have been advised by management that all journals are approved each day before being posted to the SEAS ledger.
 - Aged debtors: it was unclear at the time of our controls testing whether aged debtors reports were routinely produced and reviewed. We have subsequently confirmed that such reports are produced and reviewed by finance.

Use of resources - Government Procurement Cards

73. As a result of wider concerns in other organisations, we undertook additional work on the use of government procurement cards (GPC), this year. The work identified a relatively low level of usage within Transport Scotland (13 cards) and we found satisfactory arrangements in place to control their use.

Governance statement

74. In 2011/12 the agency included a governance statement in its annual accounts for the first time. In accordance with Scottish Government guidance, this included description and assessment of the essential components of corporate governance and details of any significant risk-related matters arising during the period. We reviewed the Governance Statement and concluded that it complied with the Scottish Government guidance.

Prevention and detection of fraud and irregularities

75. Transport Scotland is responsible for establishing arrangements to prevent and detect fraud and other irregularity. We review and report on these arrangements.

76. The overall arrangements for the prevention and detection of fraud are satisfactory although there are some specific areas which have been subject to fraudulent activity and which indicate that further improvements could be made. The agency is working towards improvements in these areas.
77. Given the circumstances of the operation of the Concessionary Travel Schemes, separate arrangements have been put in place for this aspect of the agency's activity, and the fraud policy and resource plan have been revised. The agency also has a fraud officer in place with responsibility for the whole of the organisation.
78. As at 31 March 2012, there have been five cases of suspected external fraud relating to the Concessionary Fares Scheme. Three of the cases had arisen in 2011/12, with the remaining two cases being unresolved cases from prior years. Four of these five cases related to bus drivers suspected of using found concessionary fares cards to generate fraudulent journeys and claim associated reimbursement under the scheme. The agency has developed a "hot-listing" system to identify missing concessionary fares cards, which they expect to address fraud of this type. The system is expected to be operational from autumn 2012. We will assess the impact that the introduction of this system has on the level of identified fraud as part of our 2012/13 audit.

NFI in Scotland

79. National Fraud Initiative (NFI) is a counter-fraud exercise that compares information about individuals held by different public bodies to identify circumstances that might suggest the existence of fraud or error (matches). Where matches are identified public bodies are expected to investigate these and if fraud and error has taken place, to stop payments and attempt to recover the amounts involved. Although the agency is not involved in the NFI as an individual organisation, data held on Scottish Government financial systems is sampled as part of the NFI process. No Transport Scotland related frauds were identified through the last round of the NFI.
80. Results published by Audit Scotland in May 2012 highlighted that fraud, overpayments and recoveries totalling £19.8 million in the most recent exercise and cumulatively totalling £78 million since NFI was first introduced had been identified across Scotland. The next round of NFI commences in autumn 2012.

Standards of conduct and arrangements for the prevention / detection of bribery and corruption

81. Audited bodies are responsible for ensuring that their affairs are managed in accordance with proper standards of conduct and have proper arrangements in place for implementing and monitoring compliance with standards and codes of conduct, standing orders and financial instructions. Auditors consider whether bodies have adequate arrangements in place. We have concluded that the arrangements in Transport Scotland, which are consistent with the requirements of the Scottish Government, are satisfactory and we are not aware of any specific issues that we need to identify in this report.

Best Value, use of resources and performance

82. Audited bodies have responsibility to ensure that arrangements have been made to secure best value. The Auditor General may require that we consider whether accountable officers have put in place appropriate arrangements to satisfy their corresponding duty of best value. Where such requirements are not specified we may, in conjunction with audited bodies, agree to undertake local work in this area.
83. As part of their statutory responsibilities, the Auditor General may procure, through Audit Scotland, examinations of the use of resources by audited bodies and publish reports or guidance. We may be requested from time to time to participate in:
- a performance audit which may result in the publication of a national report
 - an examination of the implications of a particular topic or performance audit for an audited body at local level
 - a review of a body's response to national recommendations.
84. During the course of our audit appointment we also consider and report on progress made by audited bodies in implementing the recommendations arising from reviews in earlier years. We may also consider the use of resources in services or functions, where the need for this is identified through local audit risk assessments.
85. This section includes a commentary on the best value arrangements within Transport Scotland. We also summarise headline results against performance measures reported by Transport Scotland for 2011/12, highlight any relevant national reports and comment on the body's response to these.

Management arrangements

Best Value

86. Scottish Government guidance for accountable officers on best value in public services requires a systematic approach to self-evaluation and continuous improvement. The guidance identifies the themes an organisation needs to focus on in order to deliver the duty of best value, but notes that implementation should be appropriate and proportionate to the priorities, operating environment, scale and nature of the body's business.
87. During 2011/12, Transport Scotland conducted best value self-assessments of Financial Management and Governance and Accountability. These assessments showed Transport Scotland to be operating efficiently in these areas. Management intend to follow up areas for potential improvement identified by these self-assessment reviews in 2012/13 in addition to conducting a Best Value self-assessment on sustainability in order to achieve continuous improvement across the organisation.

Overview of reported performance in 2011/12

88. Transport Scotland has reported that it has achieved all but 2 of the 43 key objectives detailed in the 2011/12 business plan. The two objectives not achieved are to:
- deliver a new interchange between the rail and tram networks providing connections to Edinburgh Airport and the West Edinburgh Development Area: not achieved due to delays associated with the Edinburgh Trams Project
 - continue to progress the A90 Aberdeen Western Peripheral Route (AWPR) and the dual carriageway from Balmedie to Tipperty: not achieved due to on-going legal challenge to the AWPR project.
89. While reporting of the achievement of business plan key targets in the annual report provides an overview of performance against plans for the year, this format of performance reporting does not easily allow comparison of performance from one year to the next. Transport Scotland's performance reporting arrangements would be improved through the introduction of suitable on-going performance indicators allowing the comparison of performance on a year-to-year basis.

Refer Action Plan Point 6

National performance reports

90. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. Reports in the last year of direct interest are detailed in Table 5 below.

Table 5: A selection of National performance reports 2011/12

<ul style="list-style-type: none"> • Scotland's Public Finances - addressing the challenges • The National Fraud Initiative in Scotland (see paras 75 to 77 above) 	<ul style="list-style-type: none"> • National Concessionary Travel (published 2010/11; followed up in 2011/12) • Reducing greenhouse gas emissions • Transport for health and social care
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Source: www.audit-scotland.gov.uk

Scotland's public finances - addressing the challenges

91. The report highlights that all parts of the public sector have less to spend in 2011/12 than in 2010/11, although the level of budget reduction varies significantly with central government funding experiencing the biggest reduction of 12 per cent. Although most bodies were able to agree a balanced budget for 2011/12 the report highlights the risk that savings may not be realised and that unforeseen pressures may emerge which reduce the ability to generate future savings. The report also notes that public bodies are finding it difficult to plan beyond 2011/12 as they do not have a clear view of their future budgets. It highlights the importance

of long-term financial sustainability when looking to reduce costs including consideration of key areas such as reducing workforce levels and identifying opportunities to share services.

92. The Audit and Risk Committee discussed this report and completed a self-assessment using the checklist included in the report. Management have advised that an associated action plan was unnecessary based on the results of this self-assessment.

National Concessionary Travel

93. Audit Scotland published a report on the performance audit of the National Concessionary Travel Scheme in October 2010. The audit examined the development and management of Scotland's national concessionary travel scheme and assessed its impact and cost. The report made a number of recommendations. We have followed-up action taken by Transport Scotland in respect of three of these recommendations:

- *The Scottish Government and Transport Scotland should clarify the objectives of the National Concessionary Travel Scheme and what contribution the scheme is expected to make towards the strategic objectives set out in the National Performance Framework.*

Senior Concessionary Travel and Integrated Ticketing Unit (CTITU) staff have advised us that the Concessionary Fares scheme contributes in particular towards the Scottish Government's Wealthier & Fairer, Healthier and Greener strategic objectives. As a result of the scheme providing free local and long distance bus travel throughout Scotland for older and disabled people and it thereby helps them to maintain their independence and access appropriate support when needed.

- *The Scottish Government and Transport Scotland should develop performance measures which allow it to assess the impact of the National Concessionary Travel Scheme against clear objectives and the strategic objectives set out in the National Performance Framework.*

Management advised us that appropriate performance measures will be developed over the next two years through collecting customer feedback from users of the scheme throughout 2012/13 and 2013/14. This data is expected to assist with improving the administration of the scheme, identifying the reasons for travel and the perceived benefits of the scheme, as well as informing and supporting future policy development.

- *The Scottish Government and Transport Scotland should work with councils to understand the reasons for variations in the take-up of disabled passes.*

Transport Scotland has consulted with Councils and recognises that historical variation in the take up of disabled passes is affected by variations in the number of disabled people per population, varying levels of Blue Badges and varying levels of citizens receiving DLA. The category of eligibility is not recorded by the Councils on their card management system and so it is difficult to accurately identify reasons for differences.

Management advised us that on-going contact with councils and the National Entitlement Card Programme Office is expected to ensure a consistent approach to validation of applications. In order to avoid any element of discretion, the eligibility criteria require

applicants to have already been assessed by other appropriately qualified organisations or individuals.

Reforms to be implemented under the Welfare Reform Act 2012 will lead to a roll-out of new Personal Independence Payments for eligible people with disabilities from April 2013, replacing the Disabled Living Allowance (DLA). This may affect assessments of eligibility for concessionary travel. At present concessionary travel in Scotland is available to those eligible for middle and higher rates of DLA. We have been advised that the Scottish Government aims to achieve an equivalency of access to concessionary travel for vulnerable people following the forthcoming reforms, by providing local authority guidance and training to ensure that any changes to eligibility criteria are understood and applied consistently.

We have further been advised that the National Entitlement Card Programme Office (NECPO), responsible for card management, is introducing a new card management system which is expected to have increased functionality for the recording and subsequent analysis of the detailed grounds on which people apply for concessionary travel.

Arrangements to consider national performance reports

94. The approach in place to ensure that relevant reports are considered by management and the Audit and Risk Committee could be improved. Management have advised us that relevant reports have been considered in 2011/12 and that related processes will be further updated for 2012/13.

Refer action plan point 7

Outlook

95. Going forward, Transport Scotland will be aware that a substantial element of its programmed work and expenditure is likely to be subject to performance scrutiny. While that will place a relatively high scrutiny burden upon the agency in comparison with other public bodies, this reflects the strategic importance of the projects and programmes that Transport Scotland has been tasked with delivering or helping to deliver. Over the coming years, the agency will play a key role in the delivery of the Forth Replacement Crossing, and the Edinburgh Trams, Borders Railway, Aberdeen West Peripheral Route and M8/M73/M74 upgrade projects. All of these projects, which involve substantial investment from public funds, have been and will be subject to significant political and public scrutiny. As indicated earlier in this report, our planned programme includes work to monitor the on-going development of these projects.

Appendix A: audit reports

External audit reports and audit opinions issued for 2011/12

Title of report or opinion	Date of issue	Date presented to Audit and Risk Committee
Annual Audit Plan	18 January 2012	27 January 2012
Interim update for Audit and Risk Committee	21 March 2012	16 April 2012
Key financial controls assurance report	2 May 2012	Not presented
Report on financial statements to those charged with governance (ISA260)	12 July 2012	19 July 2012
Audit opinion on the 2011/12 financial statements	9 August 2012	9 August 2012
Annual Report on the 2011/12 Audit	19 September 2012	8 October 2012

Appendix B: action plan

Key Risk Areas and Planned Management Action

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
1	16	<p>Accounts submission for audit</p> <p>We received the unaudited accounts on 15 May 2012, in accordance with the agreed timetable. However, the financial statements and supporting notes were not substantially complete until part way through our audit fieldwork on 12 June 2012. There is a risk that the efficiency of the audit process is reduced by piecemeal or frequent resubmission of elements of the financial statements.</p>	We will discuss a revised timetable for 2012/13 based on a later more complete submission for audit.	Sharon Fairweather / Lee Shedden	31 March 2013
2	20	<p>Roads depreciation and adjustment to revaluation reserve.</p> <p>There was no adjustment in the statement of change in taxpayers' equity (SoCTE) for the element of depreciation which relates to the revaluation of the road network to be released from the revaluation reserve to the general fund.</p> <p>There is a risk that the materiality of this error is likely to increase over time, becoming material in 4 years.</p>	The issue will be reviewed in 2012/13 and agreement reached over a method for determining this transaction in future financial statements.	Sharon Fairweather / Lee Shedden	31 March 2013
3	22	<p>M80 Stepps to Haggs private finance initiative (PFI)</p> <p>We reviewed the analysis of charges and balances for the M80 Stepps to Haggs PFI project and identified an error in the</p>	The error will be corrected in 2012/13, and other PFI schemes will be reviewed to determine if they	Sharon Fairweather / Lee Shedden	31 March 2013

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
		calculated interest rate applied. There is a risk that the internal analysis of payments is incorrectly categorised between interest and operating cost elements.	contain similar errors.		
4	23	Management commentary disclosures Transport Scotland outturn against budget is set out in the management commentary of the annual report and accounts, but there is no published reconciliation between the outturn and the net expenditure position in the financial statements. There is a risk that users of the financial statements are unable to interpret the difference between budgetary control outturns and the financial statement net expenditure.	We will consider including a reconciliation between budget outturn and the net expenditure in the financial statements as part of the 2012/13 accounts.	Sharon Fairweather / Lee Shedden	31 March 2013
5	27	Sustainability reporting Transport Scotland has not included a sustainability report for 2011/12 in the annual report and accounts, although it plans to publish a sustainability report separately. Whilst the Part 4 of the Climate Change (Scotland) Act 2009 does not require reporting on the duties, appropriate sustainability reporting may assist public bodies to demonstrate compliance with the climate change duties and the Public Bodies Duties Guidance encourages a voluntary approach to reporting.	We will confirm whether Transport Scotland, as an executive agency, is covered by the Scottish Government's sustainability reporting arrangements and if necessary will consider whether a sustainability report should be included in the annual report for 2012/13.	Sharon Fairweather / Lee Shedden	31 March 2013

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
6	89	<p>Performance measures</p> <p>The annual report provides an overview of performance against plans for the year, but does not provide comparison of performance from one year to the next.</p> <p>There is a risk that trends in performance are not available to enable this aspect to be considered by users.</p>	We will consider whether on-going performance indicators allow the comparison of performance on a year to year basis.	Sharon Fairweather / Lee Shedden	31 March 2013
7	98	<p>Arrangements for the consideration of Audit Scotland national reports</p> <p>Although all relevant reports have been considered in 2012/13, the approach in place to ensure that reports are considered by management and the Audit and Risk Committee could be improved.</p> <p>There is a risk that key issues and recommendations in national reports are not considered by Transport Scotland.</p>	We will consider how related processes could be improved for 2012/13.	Sharon Fairweather / Lee Shedden	31 March 2013