AUDIT SCOTLAND

Transport Scotland

2015/16 Annual Audit Report

September 2016

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Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. We help the Auditor General for Scotland and the Accounts Commission check that organisations spending public money use it properly, efficiently and effectively (www.audit-scotland.gov.uk/about/).

Brian Howarth, Assistant Director, Audit Scotland is the appointed external auditor of Transport Scotland for the period 2011/12 to 2015/16.

This report has been prepared for the use of Transport Scotland and the Auditor General for Scotland and no responsibility to any member or officer in their individual capacity or any third party is accepted.

The information in it may be used by the Auditor General for Scotland in support of her wider responsibilities, including reporting to the Scottish Parliament.

Contents

Key messages

Audit of 2015/16 financial statements	• We have given an unqualified opinion on the 2015/16 financial statements. • The net book value of the trunk road network increased by £379 million as a result of post-audit adjustments.
Financial management and sustainability	• The short term financial position of Transport Scotland remains stable with the body operating within its available funding. • Transport Scotland has a high-level long term plan covering 10 years. • The Road Asset Management Plan (RAMP) identifies a significant maintenance backlog for the trunk road network due to a lack of expenditure on this over a number of years. • The arrangements for scrutinising major rail infrastructure projects are being strengthened in response to concerns raised by the Office of Rail and Road (ORR) in their annual assessment of Network Rail.
Governance and transparency	• Transport Scotland has effective overarching and supporting governance arrangements which provide an appropriate framework for organisational decision making. • The arrangements for declaring and reviewing registrable interests should be strengthened beyond the standard Scottish Government approach currently applied.
Best Value	• Transport Scotland has a systematic approach to Best Value. • The operator of the Caledonian Sleeper franchise has encountered operational and financial performance issues during the first year of the new franchise. • Due to a number of changes in Prestwick Holdco's senior management team during the year management advised the updated business plan will not be available until autumn 2016.

Introduction

1. This report is a summary of our findings arising from the 2015/16 audit of Transport Scotland.

2. Transport Scotland and the Chief Executive, as the Accountable Officer, are responsible for:
   - acting within the law and ensuring the regularity of transactions by putting in place appropriate systems of internal control
   - maintaining proper accounting records
   - preparing financial statements which give a true and fair view of the financial position of the Agency as at 31 March 2016 and its expenditure for the year then ended
   - publishing with their financial statements an annual report, comprising a performance report and an accountability report.

3. Our responsibility, as the external auditor, is to undertake our audit in accordance with International Standards on Auditing, the principles contained in the Code of Audit Practice issued by the Auditor General for Scotland in May 2011 and the ethical standards issued by the Auditing Practices Board.

4. An audit of financial statements is not designed to identify all matters that may be relevant to those charged with governance. It is the auditor's responsibility to form and express an opinion on the financial statements prepared by management with the oversight of those charged with governance. This does not relieve management of their responsibility for the preparation of financial statements.

5. Appendix I sets out the audit risks and how we addressed these in arriving at our opinion on the financial statements.

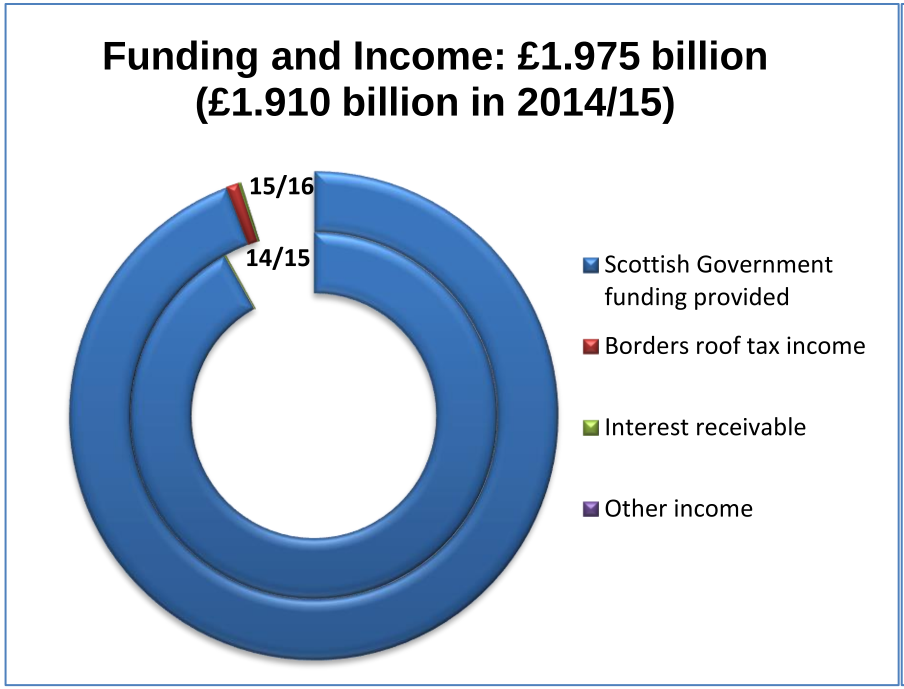
6. A number of reports, both local and national, have been issued by Audit Scotland during the course of the year. These reports are summarised at appendix II and appendix III.

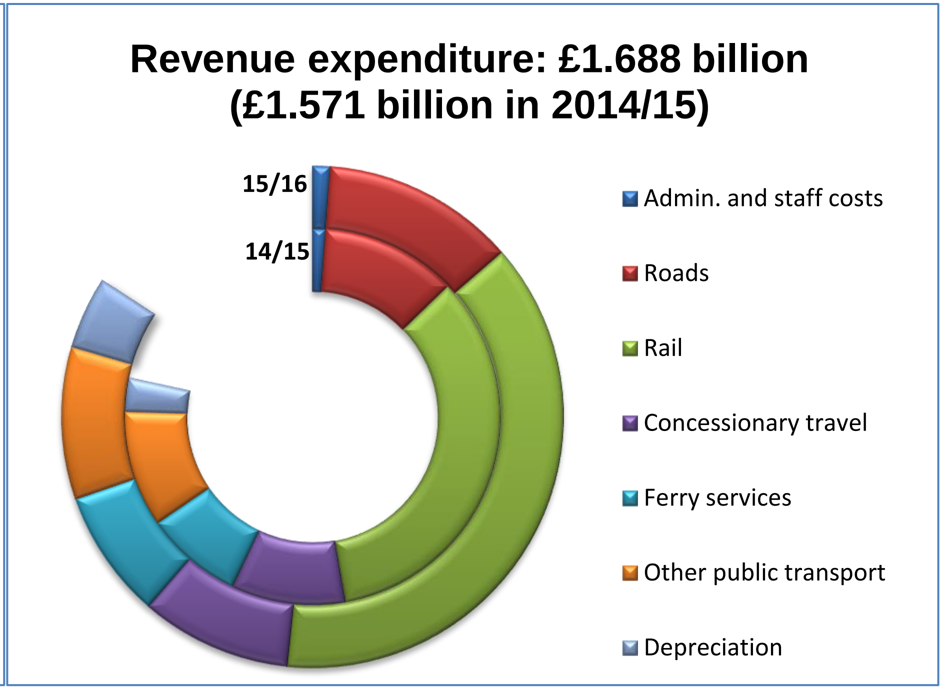
7. Appendix IV is an action plan setting out our recommendations to address the high level risks we have identified from the audit. Officers have considered the issues and agreed to take the specific steps in the column headed "Management action/response". We recognise that not all risks can be eliminated or even minimised. What is important is that Transport Scotland understands its risks and has arrangements in place to manage them. The audit and risk committee should ensure that they are satisfied with proposed actions and have a mechanism in place to assess progress and monitor outcomes.

8. We have included in this report only those matters that have come to our attention as a result of our normal audit procedures; consequently, our comments should not be regarded as a comprehensive record of all deficiencies that may exist or improvements that could be made.

9. 2015/16 is the final year of the current five year audit appointment. Audit Scotland has again been appointed as the Agency's external auditor for the next five year appointment. In accordance with agreed protocols and International Standards on Auditing we will support the incoming audit team as part of this transition.

2015/16 Financial Statements





The Statement of Changes in Taxpayers' Equity in the financial statements shows Scottish Government cash funding (including inter-entity transfers of £0.4 billion) of £1.953 billion was provided during 2015/16. This was £47 million more than in 2014/15. Income from other sources during 2015/16 was £22.1 million compared to £3.4 million in 2014/15. This increase was due to £17.5 million of income recognised in 2015/16 for amounts due to Transport Scotland from Scottish Borders Council, Midlothian Council and City of Edinburgh Council in connection with the Borders railway.

The financial statements also show that annual revenue expenditure has increased from £1.571 billion in 2014/15 to £1.688 billion in 2015/16. This was mainly due to a £73 million increase in payments to Network Rail determined by the Office of Rail and Road (ORR) and the commencement of the new ScotRail Passenger franchise and Caledonian Sleeper franchise in April 2016. There was also a £35 million increase in depreciation which reflects the results of the annual condition survey on the trunk road network.

Audit of the 2015/16 Financial Statements

Audit opinions

Financial Statements	• The financial statements of Transport Scotland for 2015/16 give a true and fair view of the state of the body's affairs and of its net expenditure for the year. • We confirm that the financial statements have been properly prepared in accordance with the 2015/16 FReM and the requirements of the Public Finance and Accountability (Scotland) Act 2000 and directions.
Regularity	• In all material respects, the expenditure and income in the financial statements were incurred or applied in accordance with any applicable enactments and guidance. • The sums paid out of the Scottish Consolidated Fund for the purpose of meeting the expenditure shown in the financial statements were applied in accordance with section 65 of the Scotland Act 1998.
Other prescribed matters	• The part of the Remuneration and Staff Report to be audited has been properly prepared in accordance with the Public Finance and Accountability (Scotland) Act 2000 and directions made thereunder by the Scottish Ministers. • The information given in the Performance Report of the Annual Report for the financial year is consistent with the financial statements.

Submission of financial statements for audit

10. We received the unaudited Annual Audit Report and Accounts and working papers on 10 June 2016, in accordance with the agreed timetable. These did not include the Remuneration and Staff Report as this was still being finalised due to a delay in the receipt of pension information from MyCSP who administer the Civil Service Pension scheme. The Performance Report was also subject to further review by the Director of Finance.

11. We were provided with the Remuneration Report on 17 June and received the updated Performance Report on 5 July.

12. The working papers were of a good standard and staff provided support to the audit team which enabled us to complete our on-site fieldwork by the planned target date of 8 July 2016.

Overview of the scope of the audit of the financial statements

13. Information on the integrity and objectivity of the appointed auditor and audit staff, and the nature and scope of the audit, were outlined in our Annual Audit Plan presented to the audit and risk committee on 1 February 2016.

14. As part of the requirement to provide full and fair disclosure of matters relating to our independence, we can confirm that we have not undertaken any non-audit related services. The 2015/16 agreed fee for the audit was £182,000 and, as we did not carry out any work additional to our planned audit activity, the fee remains unchanged.

15. The concept of audit risk is of central importance to our audit approach. During the planning stage of our audit we identified a number of key audit risks which had the greatest effect on the audit strategy, resources and effort. We set out in our Annual Audit Plan the audit work we proposed to undertake to secure appropriate levels of assurance for these areas and Appendix I sets out how we addressed each risk in arriving at our opinion on the financial statements.

16. Our audit involved obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error.

Materiality

17. We consider materiality and its relationship with audit risk when planning the nature, timing and extent of our audit and conducting our audit procedures. We assess the materiality of uncorrected misstatements, both individually and collectively.

18. We summarised our approach to materiality in our Annual Audit Plan. On receipt of the unaudited financial statements, we revised materiality for 2015/16 to £168 million based on the net book value of the trunk road network at 31 March 2016.

19. We also set a lower level, known as performance materiality, when defining our audit procedures. This is determined to ensure that uncorrected and undetected audit differences do not exceed our materiality level. Performance materiality was set at £84 million (i.e. 50% of materiality).

20. As Transport Scotland's trunk road assets dominate the Statement of Financial Position and represent more than ten times net operating expenditure, we also set a separate performance materiality level to be applied to all account areas other than the trunk road network. This has been set at 0.75% of gross expenditure and was revised upon receipt of the unaudited financial statements to £13 million.

21. We report all misstatements greater than £100,000.

Exhibit 1: Overall materiality and misstatements

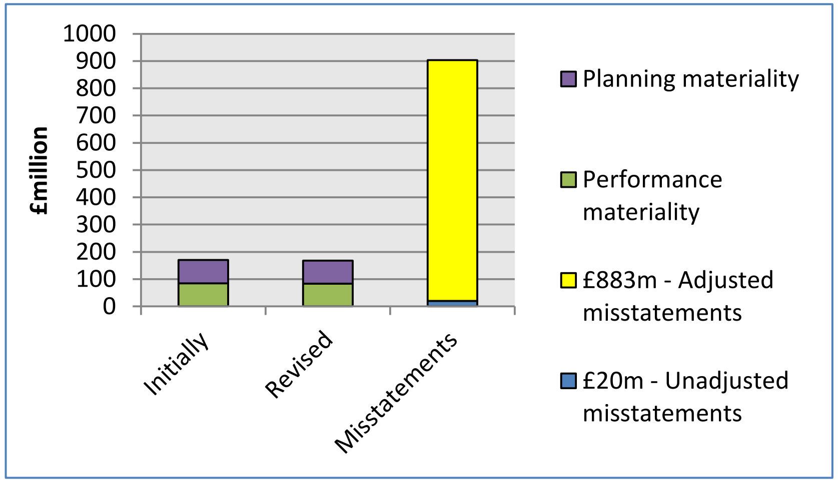
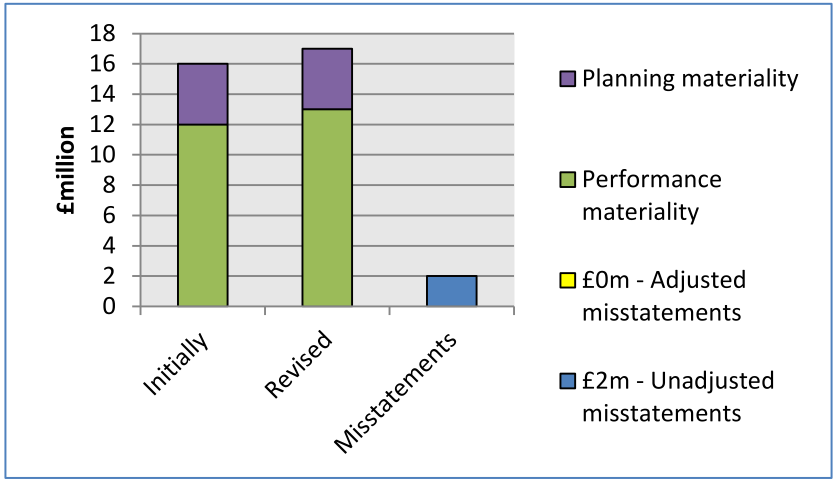


Exhibit 2: Non-trunk road materiality and misstatements



Evaluation of misstatements

22. We have identified nine misstatements in the unaudited financial statements. Five of these have been adjusted by management in the audited accounts (three errors in data from road asset valuation system (RAVs) – paragraph 33, application of Q4 Baxter's index – paragraph 34 and reclassification of reserves – paragraph 35). As a result of these changes the net book value of the trunk road network increased by £379 million. The other misstatements are unadjusted and total £22 million with the majority (£20 million) affecting the valuation of privately financed assets under construction and the remainder relating to over-estimated accruals resulting in an overstatement of expenditure of £2 million.

23. As the total value of misstatements of £905 million exceeded our overall performance materiality level of £84 million we considered the need to undertake further audit testing.

24. The nature of the majority of the errors meant that Transport Scotland were able to fully identify and correct these: they did not indicate that wider systematic errors existed in the financial statements. Errors in this category included the application of Q4 Baxter index, reclassification of reserves, calculation of land values in RAVs, and the recognition of Public Private Partnership (PPP) assets still at construction phase.

25. Our routine testing of a significant amount of the year-end payables (87% of £153 million year end accruals verified to supporting documentation), meant that we were able to conclude that there was no significant risk of a material error existing in the untested element.

26. The remaining errors concerned the translation of road network data held on Transport Scotland databases onto RAVs and these initial errors were further refined as a result of our extended testing as detailed at paragraphs 27-29.

Additional testing undertaken

27. We identified a number of significant movements in dimensional variance. To verify the validity of these changes we requested explanations and evidence in support of the seven largest movements identified.

28. Our extended audit testing included a detailed analysis of the dimensional variance on each route to identify where the significant changes had occurred. This highlighted that over 75% of the variance was on the A9/M9 and A8/M8. To verify the validity of these changes we requested explanations and evidence in support of the underlying movements. This identified a £77 million error due to the incorrect classification of walls and a further £36 million movement was due to a measurement error in prior years.

29. We have accepted that the remaining £2 million dimensional variance is due to other general changes in the measurement of the network which we have accepted as reasonable.

30. The overall impact of correcting the errors identified with the data held within RAVs was to increase the net book value of the trunk road network by £581 million (i.e. £123 million increase in roads value, £381 million increase in land value and £77 million increase in net structures value).

Significant findings from the audit

31. International Standard on Auditing 260 (ISA 260) requires us to communicate to you significant findings from the audit as detailed below:

- The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and disclosures.
- Significant difficulties encountered during the audit.

- Significant matters arising from the audit that were discussed, or subject to correspondence with management.
- Written representations requested by the auditor.
- Other matters which in the auditor's professional judgment, are significant to the oversight of the financial reporting process.

32. The following table details those issues or audit judgements that, in our view, require to be communicated to those charged with governance in accordance with ISA 260.

Table 1: Significant findings from the audit

Significant findings from the audit in accordance with ISA260

Data from road asset valuation system

33. A number of errors in the translation of road network data held on Transport Scotland databases onto the road asset valuation system (RAVs) resulted in the roads, land and structures values produced for the trunk road network valuation being incorrectly stated. This included:

- the width measurements for sections of a number of routes had been incorrectly changed from 6 metres to 7.3 metres
- an upgrade to a module of RAVs which resulted in land for a number of sections being incorrectly classified as rural rather than urban
- a change in the dimensions of the Scotstoun interchange on the A8 as this had previously been recorded in RAVs with the wrong dimensions
- the incorrect reclassification of 332 walls as ‘gravity walls’ during the year, due to a source data reader within RAVs not operating correctly after an upgrade.

This resulted in the net book value of the trunk road network increasing by £581 million (i.e. £123 million increase in roads value, £381 million increase in land value and £77 million increase in net structures value). These changes in value have been reflected in the final version of the accounts.

Appendix IV – Action Plan No. 1

Significant findings from the audit in accordance with ISA260

Indexation rate for trunk road network

34. Transport Scotland indexes each element of the road network, other than land, using a rate known as the Baxter index to ensure that the depreciated replacement cost of the trunk road network reflects inflation. The Q4 index value isn't known until mid-July each year and so the figure for Q3 is used in the Roads Asset Valuation System (RAVs) to produce the year-end road network valuation for the unaudited accounts. A further calculation is then required each year when the Q4 figure is received, to assess whether a material adjustment is required to the unaudited statements. In 2015/16 the Baxter index movement between these two quarters represented a 1.14% decrease which if applied would reduce the net book value of the trunk road network by £202 million. As this is above the overall materiality level, an adjustment has been made in the audited accounts to reflect the 2015/16 quarter 4 Baxter index figure.

Revaluation reserve adjustment

35. No amount had been released from the revaluation reserve to the general fund in the unaudited accounts to represent the element of the in-year depreciation charge on the trunk road network that is attributable to revaluation. An adjustment has been made for this in the audited accounts to transfer £100 million from the revaluation reserve to the general fund.

Recognition of Public Private Partnership assets still at construction phase

36. The Government Financial Reporting Manual (FReM) requires that the value of work on Public Private Partnership schemes is recognised as assets under construction during the build-phase. Within the unaudited accounts £240 million was recognised for the Aberdeen Western Peripheral Route and the M8, M73, M74 improvements project, based on an assessment of the work that would be completed for these schemes by 31 March 2016. During our audit, we obtained details of the final outturn for both projects and identified that £260 million of work had actually been completed during the year. The amount recognised as assets under construction, and the related payables balance, in the unaudited accounts have been understated by £20 million. Management advised us of the difficulty in assessing work completed on large capital projects prior to all claims being received and certified, and the requirement to submit an early outturn projection to the Scottish Government (in November 2015) to support the Spring Budget Revision process which contained the necessary budget adjustment. Management consider that this error is not material and have not adjusted for this in the audited financial statements.

Significant findings from the audit in accordance with ISA260

Overstatement of concessionary travel scheme expenditure

37. The concessionary travel scheme expenditure for 2015/16 of £189.1 million includes an accrual for the projected final payments due to bus operators for the year. The final outturn position showed that actual payments for 2015/16 were £187.5 million. Therefore, the amount recognised in the accounts is overstated by £1.6 million. Management advised that due to the timing of the final payments to bus operators this accrual would always be based on projected costs and as this amount is not material they have not adjusted for this in the 2015/16 audited financial statements.

Overstatement of bus service operators grant expenditure

38. The bus service operators grant expenditure for 2015/16 of £53.4 million includes an accrual for the projected final payments due to bus operators for the year. The forecast outturn position at 25 July 2016 shows that actual payments for 2015/16 are likely to be £52.9 million. Therefore, based on the most up-to-date data, these costs have been over-accrued by £0.5 million. Management advised that due to the timing of the final claims being submitted by bus operators this accrual would always be based on projected costs and as this amount is not material they have not adjusted for this in the 2015/16 audited financial statements.

Other issues from the financial statements audit

Assets and liabilities of the Forth Estuary Transport Authority (FETA)

39. From June 2015, responsibility for the maintenance of the existing Forth Road Bridge transferred from FETA to Transport Scotland. A new Forth Bridges Operating Company (FBOC) is contracted to undertake these responsibilities and those of the new Forth Replacement Crossing. The existing FETA employees transferred to the new operating company (Amey) under TUPE regulations and Transport Scotland took on the residual FETA assets and liabilities.

Forth Road Bridge valuation

40. Transport Scotland engaged the Chief Bridge Engineer for the new Forth Replacement Crossing to produce the valuation of the existing Forth Road Bridge at 31 March 2016 to be recognised as part of the trunk road network.

41. Following a review of “similar” cable stayed bridges built across the world over the last 20 years the Chief Bridge Engineer concluded that there were none that gave a good proxy for the modern equivalent replacement cost of the Forth Road Bridge. This was

due to the differences in labour costs, steel supply, fabrication and delivery costs in those markets and the impact of the geography and geology of the location on the actual construction method adopted and the resultant costs. He therefore determined that the best proxy available for the modern equivalent depreciated replacement cost would be the projected cost of the new Forth Replacement Crossing adjusted to reflect the remaining useful life of the existing Forth Road Bridge.

42. Adopting this approach resulted in the existing Forth Road Bridge being assigned a gross cost of £1 billion with a net book value of £527 million (i.e. accumulated depreciation of £473 million) and remaining useful life of 49 years at 31 March 2016.

43. As part of our financial statements audit we reviewed the methodology adopted and met with the Chief Bridge Engineer to discuss his assessment of the remaining useful life of the bridge.

44. Our review of the methodology confirmed that the construction cost used in the calculation was consistent with the projected outturn shown in the latest Forth Replacement Crossing budget monitoring report and excluded the cost of the new approach roads and other related works. We also re-performed the calculation and confirmed that the value of the asset was correctly reflected in RAVs as a special structure on the A90.

45. The Chief Bridge Engineer advised that, in assessing the remaining useful life of the bridge, the main consideration was the condition of the cable stays: as these are the components which are most likely to fail and cause the bridge to be damaged beyond economical repair. He explained that a 5 year inspection regime is in place which assesses the condition of the cables. This was last undertaken in 2012, following the completion of de-humidification work, and provided assurance that the cables will be structurally sound for at least another 40 years (the maximum period that the survey will provide assurance over). He is confident the bridge will be in a usable condition until at least 2052 and expects the actual remaining life of the bridge will exceed this resulting in a remaining useful life of 49 years based on an overall asset life of 100 years (i.e. bridge was opened in 1965).

46. Based on our review of the methodology adopted, and discussions with the Chief Bridge Engineer, we are satisfied that the value of the existing Forth Road Bridge recognised in Transport Scotland's Statement of Financial Position represents the best available estimate of the modern equivalent depreciated replacement cost of the bridge. However, we noted that a further survey of the cables is due to be undertaken in 2017. We would therefore expect the life of the bridge to be revisited following this to assess whether the remaining asset life is still appropriate.

Appendix IV – Action Plan No. 2

FETA pension cessation deficit payment

47. As part of the arrangements for the former FETA staff transferring to Amey, Transport Scotland paid a lump sum of £8.5 million to buy-out the existing pension liability at 31 March 2015. This exit payment was partly funded by the residual value of FETA reserves (£3.7 million) with the shortfall of £4.8 million funded from Transport

Scotland's 2015/16 budget. As the value of the cessation deficit payment was based on an estimate of the actual liability, the agreement with Lothian Pension Fund includes provision for Transport Scotland to make an additional payment should the actual liability be greater than the value of the payment made. The Agency has disclosed a contingent liability for this in the audited accounts and currently assesses that the requirement for any future payment is unlikely.

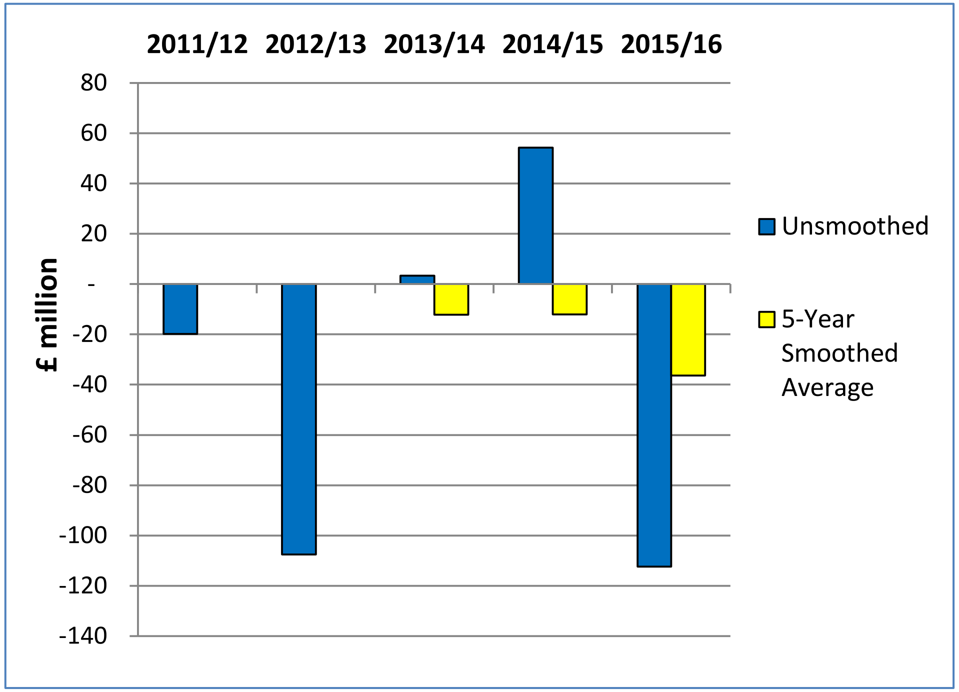
Impact of road pavement condition variance smoothing

48. In 2013/14, we agreed that Transport Scotland would apply a smoothing of the road pavement condition variance through the use of a 5-year rolling average. The smoothing process is intended to provide greater year-on-year certainty in the budgeting by dampening fluctuations caused predominantly by the effect of changes in traffic measurements in the calculation of remaining life.

49. During 2015/16 the assessed road pavement condition variance for the year was a condition deterioration of £112 million. However, this has been adjusted in the financial statements to reflect the 5-year rolling average condition deterioration of £36 million (Exhibit 3).

50. Since Transport Scotland adopted smoothing in 2013/14, £61 million has been charged for depreciation relating to the condition of the road pavement. Had smoothing not been adopted £55 million would have been charged (only £6 million less).

Exhibit 3: Impact of applying road pavement condition smoothing



Compliance with EU state aid regulations

51. During our 2014/15 audit we were made aware that a new EU Services of General Economic Interest (SGEI) regulation had come into effect in 2014 and Transport Scotland were working to adapt Highlands and Island Airports Ltd (HIAL) funding arrangements to this regulation as the existing funding and monitoring arrangements were not fully compliant. We were also informed that both the Scottish Government State Aid Unit and the European Commission

were aware of this and Transport Scotland were working towards full compliance during 2015/16.

52. Transport Scotland has advised that HIAL's 2016/17 grant letter includes a number of amendments from prior years to move towards State Aid compliance. These include:

- separating out budgetary provision into allocations for Inverness, Sumburgh and the rest of HIAL
- a requirement for HIAL's monthly cash forecast to report using the Inverness / Sumburgh / rest of HIAL split
- a requirement for capital grant claims to be itemised and for exact amounts, and
- a requirement for HIAL's monthly results package to be revised to show a clear disclosure between HIAL's commercial and non-commercial activities.

53. As a result of these changes Transport Scotland expects to be fully compliant with the SGEI regulations in 2016/17.

54. Management have advised that despite the current funding arrangements not complying fully with the SGEI regulations they do not believe there are any fundamental state aid issues with the subsidy of HIAL and, as no other operator is disadvantaged, the risk of any legal challenge is minimal.

Future accounting and auditing developments

Code of Audit Practice

55. A new Code of Audit Practice applies to public sector audits for financial years starting on or after 1 April 2016. It replaces the Code issued in May 2011. It outlines the objectives and principles to be followed by auditors. It is part of the overall framework for the conduct of public audit in Scotland.

56. The new Code increases the transparency of our work by making more audit outputs available on Audit Scotland's website. In addition to publishing all annual audit reports on our website, annual audit plans and other significant audit outputs will also now be made available online for all audited bodies. This is irrespective of whether the body meets in public or make documents such as audit committee papers routinely available on its own website.

57. Also, under the new Code, appointed auditors are required to provide conclusions on the four dimensions of wider-scope public audit:

- financial sustainability
- financial management
- governance and transparency, and
- value for money.

Public Sector Internal Auditing Standard

58. The Chartered Institute of Public Finance and Accountancy (CIPFA) has issued a revised Public sector internal auditing standard (PSIAS). Our Scottish Government external audit team will assess the Scottish Government Internal Audit Service against this revised standard as part of their 2016/17 audit.

Financial management and sustainability

Resource Departmental Expenditure Limit (DEL) underspend £35 million last year £103m	Capital Departmental Expenditure Limit (DEL) overspend £60 million last year £22m underspend	Total Departmental Expenditure Limit (DEL) Budget overspend £25 million last year £125m underspend	Total Net Assets + £483 million
Initial Budget £1,623m	Initial Budget £449m	Initial Budget £2,072m	31 March 2016 £18,032m
Final Budget £1,621m	Final Budget £449m	Final Budget £2,070m	31 March 2015 £17,549m
Actual Outturn £1,586m	Actual Outturn £509m	Actual Outturn £2,095m	
Underspend £35m	Overspend £60m	Overspend £25m	

The capital DEL overspend was entirely attributable to additional budget not being made available to cover the cost of work on the Aberdeen Western Peripheral Route (AWPR) Non-Profit Distributing (NPD) project as discussed at paragraph 61. In addition to its resource budget detailed above, Transport Scotland had Outside Departmental Expenditure Limit (ODEL) budgets of £80 million for PFI Resource (PFI service and interest charges paid in year) and £99 million for PFI Capital (cost of work undertaken on M8, M73, M74 that is recognised as an asset during the build phase). The Agency was also allocated an Annually Managed Expenditure (AME) budget of £1 million for land compensation payments and damage claims on the trunk road network. During 2015/16 there was a very small underspend of £0.012 million against the ODEL budgets and a £4.1 million underspend against the AME budget due to the release of provisions no longer required and the recovery of damage claim debts during the year.

2015/16 outturn

59. The main financial objective for Transport Scotland is to ensure that the financial outturn for the year is within the budget allocated by Scottish Ministers.

60. Transport Scotland overspent its total DEL budget by £25 million due to a £60 million overspend against the capital DEL budget.

61. The capital DEL overspend was entirely attributable to additional budget not being made available to cover the cost of work on the Aberdeen Western Peripheral Route (AWPR) Non-Profit Distributing (NPD) project. This has been reclassified by the Office of National Statistics as 'public sector spending' so now counts against the Agency's capital DEL budget. No additional budget was allocated to Transport Scotland for this in the spring budget revision but management were advised at the start of 2016 that any capital DEL overspend for such projects would be managed within the overall Scottish Government budget this year. This approach was confirmed in May 2016 in an e-mail from the Scottish Government's Director of Financial Management which gave "*authorisation to spend in excess of the 2015-16 SBR Capital DEL control total… with the resultant overspends met centrally and managed within overall Scottish Government resources".*

Release of savings and realignment of expenditure

62. During 2015/16 Transport Scotland delivered £25 million of savings on the Forth Replacement Crossing (the budget for potential contingencies that had not crystallised). The Agency also managed to release another £22 million for projects which were realigned from 2015/16 to 2016/17 as they had not yet commenced. As this was done before the Agency's 2016/17 budget was set, this expenditure is reflected in their budget settlement for 2016/17.

Forth Bridge closure

63. At the start of December 2015 a fault was identified in the structure of the existing Forth Road Bridge. This resulted in the closure of the bridge for a number of weeks to allow the extent of the fault to be fully assessed and the repairs to be undertaken.

64. In March 2016, the Scottish Government's Infrastructure and Capital Investment committee published a report on their inquiry in to the circumstances surrounding the closure of the bridge. This identified that the cost of these repairs totalled around £19.7 million. Following further review and analysis, Transport Scotland has confirmed that this issue does not suggest any underlying weakness with the bridge which will impact upon repairs and maintenance costs going forward.

2015/16 financial position

65. Transport Scotland, as an executive agency of the Scottish Government, receives almost all of its income through funding from the Scottish Government.

66. The Statement of Financial Position at 31 March 2016 shows net assets of £18 billion. This position is largely attributable to the value of the trunk road network which is subject to an annual valuation.

67. The short term financial position of Transport Scotland remains stable with the body operating within its available funding and reporting an excess of assets over liabilities. As in previous years the Statement of Financial Position shows a shortfall of current assets against current liabilities at the year end but this is attributable to the Agency not carrying cash reserves due to cash being made available by the Scottish Government as required.

2016/17 financial outlook

68. Transport Scotland has an allocated budget of £2.2 billion for 2016/17.

69. The resource DEL budget element of this, £1.6 billion, is in line with the Agency's 2015/16 allocation. The capital DEL budget of £510 million represents a 14% increase on 2015/16 which reflects the additional budget cover required for the Aberdeen Western Peripheral Route which was not provided in the current year (see paragraph 61 for details).

70. Management anticipate that an additional ODEL budget for PFI Capital and an Annually Managed Expenditure (AME) budget will be allocated by the Scottish Government as part of their autumn / spring budget revisions. This is consistent with the practice followed in recent years.

Future payments due to Network Rail for rail infrastructure projects

71. The Office of Rail and Road (ORR) is the independent regulator for the rail industry. The ORR determine the amount of capital and revenue funding the UK and Scottish Government's provide to Network Rail for each 5 year period, known as control periods.

72. In the 2 years before a new control period the UK and Scottish Government negotiate with Network Rail over what projects will be taken forward as part of the next control period. Where possible, this includes agreeing the cost and timescale for the projects, which are then included within the ORR determination as fixed costs. Network Rail bears the budgetary risk of these projects. However, if agreement cannot be reached or if there is too much uncertainty over the cost then an estimate is included in the determination. In these cases the budgetary risk is borne by the UK / Scottish Government, subject to the ORR reviewing the final costs to determine that they are reasonable (and not down to inefficiencies on Network Rail's part).

73. The current determination for control period 5 covers the period from 2014-2019 (i.e. financial years 2014/15-2018/19) and sets out the costs (at 2012/13 prices) of each of the Scottish projects given in Network Rail's Strategic Business Plan as shown in Exhibit 4.

Exhibit 4: Scottish project costs in Network Rail's SBP

Projects and funds (2012-13 prices)	SBP (£m)
Committed obligations	
EGIP Electrification (Springburn to Cumbernauld)	26
EGIP Electrification (Glasgow to Edinburgh via Falkirk High)	124
EGIP (Edinburgh Gateway Station)	31
EGIP Infrastructure works	308
Borders Railway	124
Total committed projects	**613**
Other Scottish projects	
Aberdeen to Inverness improvements phase 1	280
Highland Main Line journey time improvements Phase 2	121
Rolling programme of electrification	171
Motherwell re-signalling enhancements	3
Motherwell area stabling	10
Other projects to meet the outputs	80
Total other Scottish projects	**665**

74. The costs of some of these projects were accepted by the ORR, and Network Rail bears the risk, however this does not apply to

- Edinburgh Glasgow Improvement Project (EGIP) Infrastructure works
- Highland Main Line Journey Time Improvements Phase 2; and
- Aberdeen to Inverness Improvements Phase 1.

75. Due to the high level of uncertainty over the costs of these projects the final amount to be paid will be agreed once there is more certainty over the actual costs (i.e. the ORR reserve the right to determine the cost of these projects at some point in the future).

76. At the start of July 2016 the ORR published its annual assessment of Network Rail which raised concerns about the progress and cost of delivering the projects within their Strategic Business Plan (SBP). Given the potential financial risk exposure for overspends on these projects, Transport Scotland has held a number of high level discussions with Network Rail senior officials and has commenced a review focussed initially on the Edinburgh Glasgow Improvement Programme (EGIP) but which will extend to other major rail projects.

77. The first phase of this review has been completed with Network Rail promising more transparency. There will also be a 'clienting unit' convened involving Transport Scotland officials and the ScotRail Alliance sponsorship team to monitor progress and costs.

78. In addition Transport Scotland is strengthening its scrutiny of major projects through:

- a new quarterly rail portfolio board chaired by the Chief Executive.

- Individual project boards chaired by Transport Scotland's senior responsible officers
- a two-weekly major projects review panel.

79. Management have advised that there is no immediate impact on the provision of rail services and the ultimate delivery date for EGIP is unaffected. However, there remains a risk that any changes in the actual costs of rail projects will impact upon the level of future payments due to Network Rail for rail infrastructure projects.

Financial Planning

80. In June 2014, Audit Scotland reported on Scotland's public finances and identified that public bodies "face increasingly difficult choices in reducing spending while maintaining service standards and meeting rising demand". The report identified that financial planning improvements were required by public bodies.

81. In the local government overview report in March 2016, Audit Scotland set out some key questions, which can apply across the Scottish public sector. These questions provide a framework for our assessment of financial planning in Transport Scotland (see below).

Table 2: Assessing financial planning

Assessment of financial planning in Transport Scotland
How fully do financial plans identify estimated differences between income and expenditure (budget shortfall)?
82. Transport Scotland prepared its 2016/17 business plan and budget based on the overall Scottish Government allocation for the year (and assuming an additional ODEL budget allocation for PFI Capital). This identifies the budget by directorate, and below that to each expenditure programme, to allow potential budget pressures to be identified. As 90% of the Agency's annual expenditure is contractually committed (i.e. payments for long term contracts such as the rail and ferry franchises) there is much greater certainty over their projected expenditure than in many other public sector organisations but there is also far less scope to reduce activity to make budget savings. As a result it is vital to Transport Scotland achieving a balanced budget position each year that they identify any potential budget shortfalls at an early stage so they can put plans in place to manage these during the year. Transport Scotland is not currently identifying a budget shortfall in its one-year plan.

Assessment of financial planning in Transport Scotland

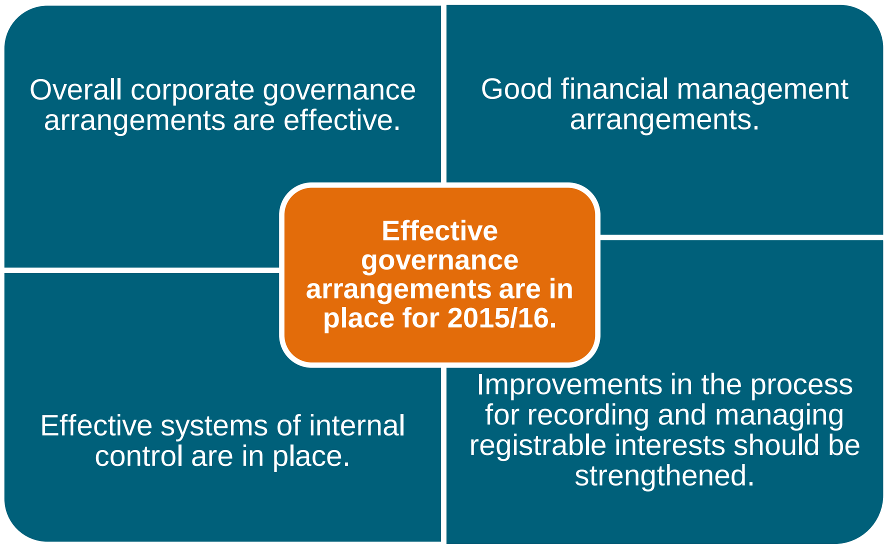
What options do they have to address this budget shortfall for example redesign services or use reserves? How big is the remaining funding gap after they implement these options? What actions are they taking to close any remaining funding gap?

83. As noted above, 90% of Transport Scotland's annual expenditure is contractually committed so there is limited scope for management to reduce activity to make budget savings. The Agency does not undertake any income generating activities and does not have the option to increase revenue to address budget shortfalls. Transport Scotland's only option to address budget shortfalls is to reduce expenditure on areas of discretionary spending either by delivering savings or more commonly reducing activity. For example, in 2015/16 Transport Scotland identified a budget shortfall for carriageway structural maintenance expenditure, where the annual budget available of £35 million is significantly less than the average projected requirements of £66 million per annum to maintain carriageways in their current condition (87% good or fair) over the next 10 years. To address this and remain within budget the Agency will require to either reduce planned carriageway structural maintenance activity or release funds from other budgets to offset the projected overspend. This is consistent with the approach adopted in recent years. However, the Agency is aware that this approach has a longer term impact as year-on-year reductions in repairs and maintenance activity is only sustainable in the short term and often leads to increased costs when that activity is finally undertaken.

Do they have a long-term financial strategy covering at least five years that accounts for future pressures? Is their five-year strategy supported by detailed financial plans covering a minimum period of three years? How well do their financial plans set out the implications of different levels of income spending and activity? How does their financial strategy link to their vision for the future?

84. Transport Scotland has prepared a high-level long term plan which sets out budget requirements for the next 10 years (i.e. up until 2026/27) based on current spending programmes and priorities, and other contractual and ministerial commitments. This plan is used to identify emerging budget pressures and to highlight the longer term impact of current spending decisions. Where significant pressures have been identified, these have also been ranked in order of priority in order to assist Ministers when making future spending decisions and allocating additional resources for specific transport programmes or funding "shovel-ready" projects. From a review of the long term plan we identified that there are specific pressures around the available budget for structural repairs, network strengthening, and routine and winter maintenance expenditure on the trunk road network. As discussed at paragraph 83 above, the Agency has identified in their Road Asset Management Plan (RAMP) that there is a significant maintenance backlog for the trunk road network due to a lack of expenditure on these areas over a number of years.

Governance and transparency



Corporate governance

85. As Transport Scotland does not have a board which operates as a decision making forum, governance of the Agency is provided by the Senior Management Team (SMT), comprising the executive directors. It also has an Audit and Risk Committee. This structure reflects the primacy of Scottish Ministers in decisions on Transport Scotland activity. Key decisions are also subject to scrutiny in the Scottish Parliament.

86. The Accountable Officer is responsible for establishing arrangements for ensuring the proper conduct of the affairs of Transport Scotland and for monitoring the adequacy of these arrangements.

87. We concluded that Transport Scotland has effective overarching and supporting governance arrangements which provide an appropriate framework for organisational decision making.

Financial management

88. As auditors we need to consider whether bodies have established adequate financial management arrangements. We do this by considering a number of factors, including whether:

- the officer responsible for finance has sufficient status to be able to deliver good financial management
- standing financial instructions and standing orders are comprehensive, current and promoted within the body
- reports monitoring performance against budgets are accurate and provided regularly and timeously to budget holders
- monitoring reports do not just contain financial data but are linked to information about performance
- audit committee members provide a good level of challenge and question significant variances.

89. Based on our accumulated knowledge, our review of Senior Management Team meeting papers and through attendance at the

Audit and Risk Committee we concluded that Transport Scotland has good financial management arrangements in place.

Transparency

90. In April 2015 the Scottish Government updated their On Board guidance (http://www.gov.scot/Publications/2015/04/9736/0) for board members of Non Departmental Public Bodies (NDPBs). This set out how boards should demonstrate high standards of corporate governance at all times including openness and transparency in decision making.

91. We reported in our Annual Audit Plan that the Scottish Government was preparing similar guidance for Executive Agencies and that Transport Scotland has been heavily involved in the consultation process for this.

92. The Scottish Government has still to publish guidance for Executive Agencies but Transport Scotland has advised they will review its governance arrangements against the applicable recommendations in the new guidance once it is available.

Internal control

93. No material weaknesses in the accounting and internal control systems were identified during the 2015/16 audit which could adversely affect the organisation's ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements.

Internal audit

94. Internal audit provides the Audit and Risk Committee and Accountable Officer with independent assurance on the overall risk management, internal control and corporate governance processes. We are required by international auditing standards to make an assessment of internal audit to determine the extent to which we can place reliance on its work. To avoid duplication, we place reliance on internal audit work where possible.

95. As part of our risk assessment and planning process our Scottish Government external audit team assessed the Scottish Government Internal Audit Division, Transport Scotland's internal auditors, and concluded that they operate in accordance with the Public Sector Internal Audit Standards (PSIAS). This enabled us to place reliance on the work of internal audit, in terms of our wider code of audit practice responsibilities.

96. During 2015/16 internal audit issued five reports covering: accounts payable and accounts receivable, project bank accounts, Clyde and Hebrides ferry procurement, management and operation of PFI / PPP projects and a review of the Scottish Roadworks Commissioner. They also issued an annual assurance statement which provided substantial assurance over Transport Scotland's risk management, control and governance arrangements.

Arrangements for the prevention and detection of fraud

97. Transport Scotland is responsible for establishing arrangements to prevent and detect fraud and other irregularity. We reviewed and reported on these arrangements and have concluded that there are effective arrangements for the prevention and detection of fraud.

Arrangements for maintaining standards of conduct and the prevention and detection of corruption

98. 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. We consider whether bodies have adequate arrangements in place. We have concluded that appropriate arrangements exist within Transport Scotland but the arrangements for the declaration and review of registrable interests could be strengthened as discussed below.

Register of interests

99. During 2013/14 we recommended that the register of interests maintained by Transport Scotland should be extended beyond the requirements of the FReM to cover all officers involved in significant contract / procurement projects and updated annually. This was discussed at the Audit and Risk Committee, where management stated that the current arrangements set out within their Standards of Propriety comply with the Civil Service Code and are consistent with Scottish Government guidance and they felt this was sufficient. This year we have identified an issue with the register of interests which we believe highlights that the current arrangements aren't sufficient for the circumstances of the organisation.

100. The Civil Service Management Code (https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/418696/CSMC-_April_2015.pdf) sets out regulations and instructions to departments and agencies regarding the terms and conditions of service of civil servants and the Conduct and Principles chapter provides quite a narrow definition of "interests" and expects "*Civil servants to declare … business interests (including directorships) or holdings of shares or other securities which they or members of their immediate family (spouse, including partner where relevant, and children) hold, to the extent which they are aware of them..*" The Scottish Government guidance reflects the requirement for senior staff to disclose financial interests and those of their immediate family but does not extend this to other private interests. Transport Scotland complies with this guidance.

101. Given the high level of procurement activity undertaken by the Agency, and the additional risk this potentially exposes staff to of false and / or malicious allegations, we feel the register of interests should be extended, where issues may be reasonably expected to be relevant to roles undertaken by staff, to cover:

- other potential conflicts of interests – close friendships

- all staff – not only a limited number of senior staff
- an annual personal declaration – including where there are no interests to declare
- an internal review and management plan / process of any potential matters.

102. This would provide a more robust process for declaring and registering interests to evidence how these are managed to avoid any real, or perceived, conflicts of interest arising.

Appendix IV – Action Plan No. 3

Correspondence referred to the auditor by Audit Scotland

103. As part of our wider Code responsibilities we are required to consider issues raised and follow these up as part of our risk based approach to the audit if they fall within our remit.

104. In November 2015 we received an item of correspondence from a councillor advising that one of his constituents had raised concerns with him about the quality of the construction of the Aberdeen Western Peripheral Route, and the potential impact on the public purse of cost overruns. Following consideration of the points raised, and discussion with the Director of Major Transport Infrastructure Projects, we responded to the correspondent advising that the risk of cost overrun lies with the contractor, not with Transport Scotland, and that we were satisfied that appropriate quality control processes are in place to ensure that the work is undertaken to a sufficient standard.

Best Value

Arrangements for securing Best Value

105. Accountable officers have a specific responsibility to ensure that arrangements have been made to secure Best Value.

106. During 2015/16 Transport Scotland conducted a best value self-assessment of People Management using Audit Scotland's best value toolkit. This identified that the Agency demonstrated a robust and forward looking approach to the area and made a number of key recommendations for further improvement relating to learning and development, flexibility of resources and the use of benchmarking which will be progressed in 2016/17.

107. Follow up reviews and reassessments were also conducted on financial management, and governance. These found that significant progress had been made across all areas of the business and the actions identified from these reviews have been taken forward.

108. In 2016/17, management intend to conduct a further best value self-assessment of Procurement.

109. From review of Transport Scotland's programme of best value self-assessments we consider this demonstrates a systematic approach to self-evaluation and continuous improvement.

Local performance audit reports

Performance of the Caledonian Sleeper franchise

110. As part of our 2015/16 audit activity we carried out a high-level review of performance in the first year of operation of the new Caledonian Sleeper franchise. This focussed on whether the operator was providing performance, and other, information required under the contract and what this information was saying about early performance.

111. The report on this work was issued in March 2016 and highlighted that the franchise operator incurred initial losses, has had issues with the existing rolling stock and has not met some of the performance standards. It also explored whether the extent of the operator's projected losses could lead to them walking away. Transport Scotland did not believe that there was evidence there was a significant risk of the operator defaulting on the contract in the short-term and we concurred with that view.

Caledonian Sleeper franchise bid evaluation

112. In addition to the performance work on the franchise, we also reviewed the bid evaluation and contract award process based on the high-level documentation.

113. We reviewed the qualitative assessment undertaken on each bidder and identified the relative differences between each bid in order to assess the impact that this had on the overall contract award decision. Based on this work, we were satisfied that the qualitative

evaluation was consistent with the approach set out in the Invitation to Tender (ITT) and did not require any further information or discussion of the qualitative evaluation of the bids.

114. The information provided for the financial evaluation showed the risk and equalisation adjustments made to each of the bids and the final assessed net present value (NPV) of each bid. We also obtained copies of the financial models of all three bidders to allow us to undertake additional analysis.

115. Our review confirmed that the assessed NPV for each bidder was consistent with the underlying financial model. We identified a number of areas where there was a significant divergence between the costs and revenues in the three bids. As a result of this we met with Ernst and Young LLP (financial advisors for Caledonian Sleeper franchise) and held a teleconference with Atkins (technical advisors for Caledonian Sleeper franchise) in June to discuss the assessment approach.

116. The identified approach included a financial comparator model, which was used in the bid evaluation. The comparator model projected revenues and costs forward using data on the current / historic performance of the franchise, to assess the affordability of the future franchise. It therefore represented a 'roll-forward' of existing revenues / costs, supplemented by information on known future revenues / costs where appropriate. This was used as a guide, alongside the evaluation of bidder Delivery Plans, to assess whether the demand, cost and revenue forecasts within each bid were realistic.

117. As highlighted in our report on the Performance of the Caledonian Sleeper franchise there is a significant degree of uncertainty over the impact of the new train fleet on passenger numbers and revenue from year four in the winning bid. This was the only bid to offer new, rather than refurbished, rolling stock and is therefore the only bid to include this degree of uncertainty after year four. As a result the demand and revenue projections within their bid after year 4 sit outwith the limits of the comparator model. We therefore sought to establish how the longer-term viability of the bids was assessed during the evaluation process.

118. The longer-term viability assessment focussed on a review of the annual demand and revenue growth in the bidders' proposals against forecast capacity. This included an assessment of the demand forecasts against the available capacity. This confirmed that the annual demand forecasts did not exceed capacity in any of the three bids. We were also advised that it was the expectation that all bidder forecasts would provide higher levels of demand, revenue and cost than the comparator model to reflect the impact of the initiatives contained within their corresponding Delivery Plans (e.g. investment in new trains, marketing, etc.).

119. Based on our review of the approach adopted to assess the viability of the bids we are satisfied that this was reasonable and reflected the bid evaluation methodology set out within the Invitation to Tender.

Workforce Planning

120. Audit Scotland published a report on *Scotland's Public Sector Workforce* in November 2013. We carried out a follow-up audit at Transport Scotland in February and March 2016, based on the recommendations in the 2013 report.

121. Transport Scotland does not have a formal workforce plan in place. Instead, staffing and resource planning is considered by budget holders on an ongoing basis to identify resource requirements and potential pressures (e.g. two upcoming Transport Bills that will require significant resources to implement). This is informed by monthly staff costs reports produced by the Transport Scotland finance team, with support from HR, which include details of headcount and current vacancies by directorate.

122. The Agency also undertook a separate review in May / June 2015 to assess long standing vacancies, emerging issues and how these sat relative to their permanent headcount cap. This required a critical assessment of vacant posts, agreement of a three year strategy to address engineering vacancies and the introduction of a corporate consideration of new post requests so that relative priorities could be discussed and opportunities for redeployment / development of other staff considered. Transport Scotland plan to repeat this exercise on an annual basis to ensure that as far as possible staffing levels and designations match their current requirements.

123. Though no formal workforce plan is in place, we are satisfied that the Agency has appropriate arrangements to ensure that staffing levels are effectively monitored and managed.

National performance audit reports

124. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2015/16, a number of reports were issued as outlined in Appendix III.

Maintaining Scotland's roads: A follow-up report

125. In May 2013, the Accounts Commission published *Maintaining Scotland's roads: An audit update on councils'* progress. The 2013 audit report found the following:

- The condition of local roads had improved marginally since 2010.
- Some progress had been made with the introduction of Road Asset Management Plans and performance indicators but further work was needed.
- The National Roads Maintenance Review was progressing but significant new ways of working would take time to put in place.

Overall, the Accounts Commission recognised that although councils were facing budget constraints, they needed to improve the condition of Scotland's roads more quickly.

126. During 2015/16, Audit Scotland undertook a further follow up review. The report on this work was published in August 2016 and is of

particular relevance to Transport Scotland. It highlighted the real terms reduction in trunk roads maintenance expenditure over a number of years and the extent of future investment required to address the backlog maintenance issues identified by the Agency in their current Road Asset Management Plan (RAMP).

Prestwick Airport

127. Audit Scotland published a report on the *Scottish Government's purchase of Glasgow Prestwick Airport* in February 2015. One of the key recommendations of the report was that a clear strategy should be put in place, which takes into account future development potential, and includes: robust business and financial plans, full evaluation of potential risks, and a well-defined, regularly reviewed exit strategy.

128. As part of our 2015/16 audit activity we had planned to review an updated business plan to ensure it addresses the recommendations made in the national report. However, an updated business plan had not yet been provided.

129. Management advised that the delay in the finalisation of the updated business plan was due to a number of changes in Prestwick Airport's senior management team during the year. The updated business plan is now expected in autumn 2016.

130. Transport Scotland's financial statements identify that Prestwick Holdco Ltd reported a loss of £9.7 million on a turnover of £10.6 million in 2015/16. These financial results are worse than was envisaged in either the business case at procurement (turnover £15.6 million and loss of £2.9 million) or the revised business case at May 2014 (turnover £13.6 million and loss of £0.8 million).

131. The loan support provided by Transport Scotland to the company is in line with the business plan commitments.

132. As losses are greater than expected at this stage, we expect that a revised business plan will set out the long term prospects for the airport and identify the potential financial commitments of Transport Scotland.

Acknowledgements

133. We would like to express our thanks for the cooperation and assistance afforded to the audit team during the 2015/16 audit, and throughout the course of the five year audit appointment.

Appendix I: Significant audit risks

The table below sets out the audit risks we identified during the course of the audit, how we addressed each risk, and our judgement in arriving at our opinion on the financial statements.

Audit Risk	Assurance procedure	Results and conclusions
Financial statement issues and risks		
Changes to Annual Report disclosure requirements The 2015/16 Government Financial Reporting Manual (FReM) has been extensively rewritten to revise the layout and content of the Annual Report. *There is a risk that the new requirements will not be reflected in the Agency's 2015/16 Annual Report and Accounts.*	• We met with finance in February 2016 to discuss the required changes and their proposals for the revised Annual Report layout and content. • We reviewed the Annual Report included within the unaudited financial statements against the requirements of the 2015/16 FReM as part of the financial statements audit.	Our review did not identify any significant departures from the requirements of the 2015/16 FReM. However, a number of minor amendments to the Annual Report were identified to ensure this reflected the disclosure requirements set out for the new Performance Report and Accountability Report sections. Management reflected the required changes in the final version of the accounts.

Audit Risk	Assurance procedure	Results and conclusions
Complexity of trunk road network valuation The process used to produce the trunk road network valuation for the accounts involves the application of indexation rates and a number of other adjustments to the data produced from the RAVs database. *There is an inherent risk of material misstatement in the trunk road network valuation due to the complexity of the valuation process.*	• We explored with Transport Scotland whether the provisional Q4 Baxter index, or another more accurate estimate than the Q3 Baxter index, could be used in the preparation of the 2015/16 unaudited financial statements.	Following consideration of alternative approaches to using the Q3 Baxter index for the trunk road network valuation for the unaudited financial statements we concluded that, due to the lack of the early availability of a provisional Q4 Baxter index figure, the Q3 figure still represented the best estimate available for the production of the annual unaudited accounts. As reported at paragraph 34, an adjustment has been made in the final version of the accounts to reflect the 2015/16 quarter 4 Baxter index figure.

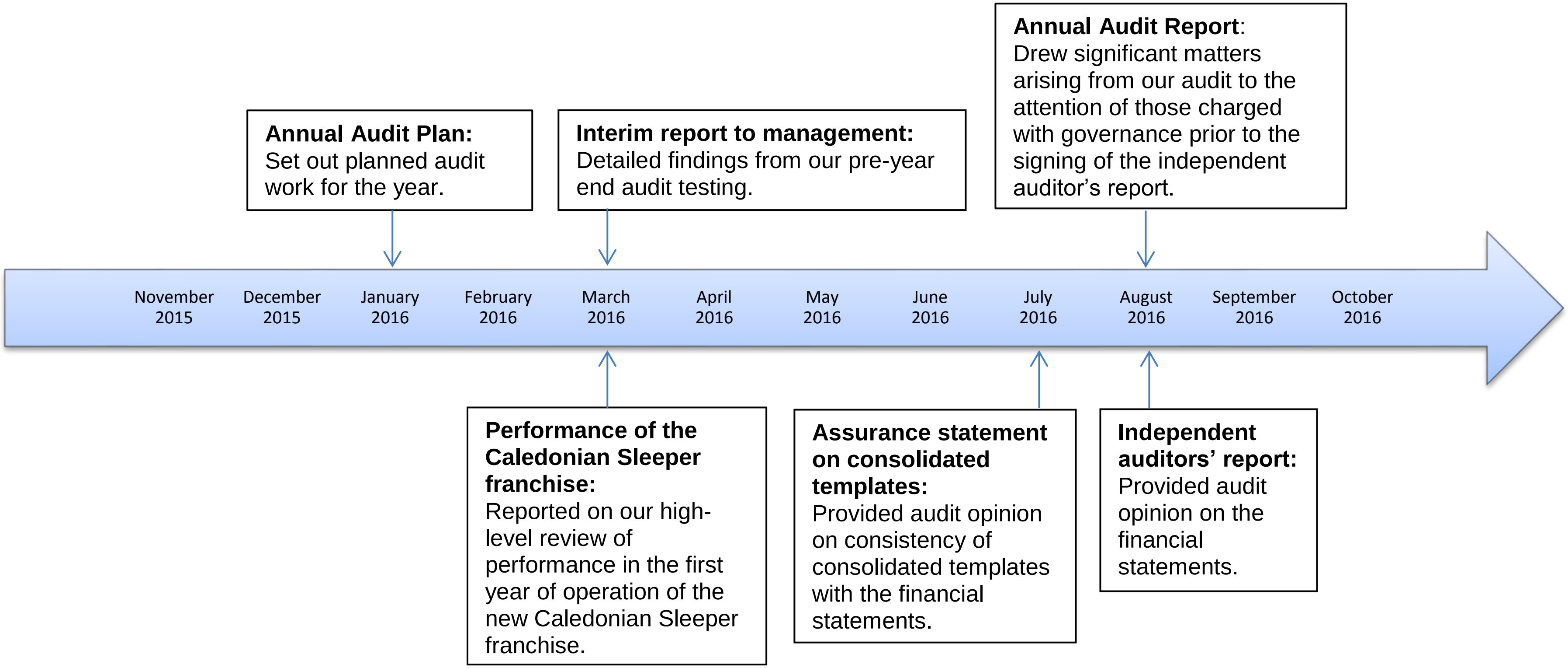
Audit Risk	Assurance procedure	Results and conclusions
Assets and liabilities of the Forth Estuary Transport Authority (FETA) Transport Scotland has taken on the residual FETA assets and liabilities. *There is a risk that Transport Scotland's 2015/16 financial statements do not accurately reflect the assets and liabilities of the former FETA.*	• We reviewed the valuation of the Forth Road Bridge. • We reviewed the exit payment in respect of the pension liability.	As reported at paragraph 46, based on our review of the methodology adopted we are satisfied that the value of the existing Forth Road Bridge represents the best available estimate of the modern equivalent depreciated replacement cost of the bridge. As reported at paragraph 47, Transport Scotland paid a lump sum of £8.5 million to buy out the existing pension liability at 31 March 2015. We verified the payment made to Lothian Pension Fund (via City of Edinburgh Council). We also examined any potential future liability for pension costs and concluded that the existing disclosures were appropriate.
Additional account area for testing Our preliminary analytical review of the Agency's 2015/16 budget identified that budgeted expenditure for Vessels and Piers (Capital) has increased significantly from the prior year. *There is a risk that this area is increasingly material and additional and new expenditure is subject to different controls / judgements.*	• We reviewed a sample of Vessels and Piers payments as part of our interim audit testing.	As reported in our Interim audit report to management 2015/16, we verified 4 loan payments totalling £12.2 million (33% of projected expenditure for the year) to CMAL for the procurement of vessels for ferry services to supporting documentation (i.e. overarching loan agreement and draw down request) and determined that the payments were accurately recorded.

Audit Risk	Assurance procedure	Results and conclusions
Accounting estimates Transport Scotland's Statement of Financial Position as at 31 March 2014 contained a non-current asset balance of £17.1 billion relating to the Road Network, £1.2 billion for Assets Under Construction, a provisions balance of £100 million and £169 million of expenditure accruals. *As these amounts contain estimation uncertainty there is an increased risk of material misstatement related to their susceptibility to unintentional or intentional management bias.*	• We assessed the impact of applying the quarter 4 Baxter factor on the value of the trunk road network. • We substantively tested year-end accruals.	As reported at paragraph 34, an adjustment has been made in the final version of the accounts to reflect the 2015/16 quarter 4 Baxter index figure. As reported at paragraphs 37 and 38, two overstated accruals were identified through testing. These were both due to the lack of available information at the time the accrual was assessed and we accept that these were based on the best estimate available at the time. Differences are reported as unadjusted misstatements and are not material to the financial statements.
Risk of management override of control Management have the ability to override controls. *There is an inherent risk that management manipulate accounting records and prepare fraudulent or biased financial statements by overriding controls that otherwise appear to be operating effectively.*	• Detailed testing of journal entries. • Review of accounting estimates. • Evaluation of significant transactions that are outside the normal course of business.	Through the assurance procedures undertaken we did not identify any attempt by management to manipulate the financial position through the override of controls.

Audit Risk	Assurance procedure	Results and conclusions
Compliance with EU state aid regulations Transport Scotland provide funding, and other support, to a range of bodies who are engaged in commercial activities. *Given the nature of Transport Scotland's operations we consider that non-compliance with EU state aid regulations represents an inherent risk to our regularity opinion on the 2015/16 financial statements.*	• We reviewed the value of the outstanding loans and the deferred interest to Prestwick Holdco • We reviewed the action being taken to address any areas of identified non-compliance. • As part of our audit testing we reviewed the terms of any funding provided to assess whether this could give the recipient an unfair commercial advantage over competitors. • We reviewed other transactions to identify any arrangements that do not appear to reflect commercial considerations, e.g. write off of debts, purchase / sale of assets for above / below market value, and provision of soft loans and financial guarantees.	The value of loans provided to Prestwick Holdco during the year (i.e. £10m), and the interest rate applied, was in line with the original business plan. As reported at paragraphs 51-54, management have advised that despite the current funding arrangements not complying fully with the SGEI regulations they do not believe there are any fundamental state aid issues with the subsidy of HIAL and, as no other operator is disadvantaged, the risk of any legal challenge is minimal. Revised arrangements have also been in put in place to ensure they are fully compliant with the SGEI regulations for 2016/17. Our testing did not identify any other funding agreements, or other transactions, that could be considered to give the recipient an unfair commercial advantage over competitors.

Audit Risk	Assurance procedure	Results and conclusions
Wider dimension issues and risks		
Forth Bridge Closure The existing Forth Road Bridge was closed to allow repairs to be undertaken to a fault in the structure. There were additional repair costs and costs associated with contingency arrangements while the bridge was closed and further repairs will be required. *There is a risk that these costs will have a significant impact on the financial position of Transport Scotland*	• We reviewed the Scottish Government's Infrastructure and Capital Investment Committee's report on the inquiry in to the circumstances surrounding the closure of the Forth Road Bridge. • We reviewed Transport Scotland's response to the findings of the report on the inquiry in to the circumstances surrounding the closure of the Forth Road Bridge.	As reported at paragraph 64, the Scottish Government's Infrastructure and Capital Investment committee's report on their inquiry in to the circumstances surrounding the closure of the bridge identified that the cost of the repairs totalled around £19.7 million. Transport Scotland confirmed that this fault in the structure does not suggest any underlying weakness with the bridge which will impact on repairs and maintenance costs going forward.
Prestwick Airport The business plan for Prestwick Airport requires to be updated to reflect the changes in circumstances that have occurred since the previous business plan was prepared in May 2014. *There is a risk that Prestwick Airport does not have a viable long-term plan to return it to profitability.*	• We reviewed Prestwick Holdco's financial results for 2015/16. • We reviewed the value of the outstanding loans and the deferred interest to Prestwick Holdco.	As reported at paragraphs 127-132, an updated business plan has not yet been provided. Prestwick Holdco's 2015/16 financial results are worse than was envisaged in either the business case at procurement or the revised business case at May 2014. The value of loans provided to during the year, and the interest rate applied, was in line with the original business plan.

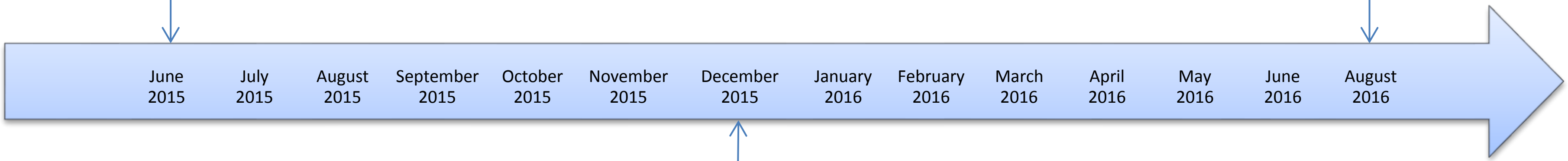
Appendix II: Local audit reports 2015/16



Appendix III: Summary of national reports

Managing ICT contracts in central government – an update:
This report reviewed the progress that the Scottish Government and central government bodies had made against the recommendations in our previous report on managing ICT contracts.

Maintaining Scotland's roads – a follow-up report:
This report reviewed changes in road condition and spending on roads maintenance since our previous report, progress made against previous audit recommendations and progress in implementing the actions set out in the 2011 National Road Maintenance Review.



Implementing the Scotland Act 2012 – an update:
This report assessed how effectively Revenue Scotland implemented, and is collecting, the two devolved taxes introduced in April 2015. It also examined how the Scottish Government is working with HM Revenue and Customs to prepare to introduce the Scottish rate of income tax in April 2016, and looked at how the Scottish Government is developing its financial management and reporting.

Appendix IV: Action plan

No.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
1	33	**Data from road asset valuation system** A number of errors in the translation of road network data held on Transport Scotland databases onto the road asset valuation system (RAVs) resulted in the roads, land and structures values produced for the trunk road network valuation being incorrectly stated by £581 million. Management should ensure that appropriate checks are undertaken so that identifiable errors and / or anomalies in the information produced by RAVs are corrected prior to the production of the unaudited accounts. This should include both checks performed by Atkins (who are responsible for maintaining the RAVs database) and Transport Scotland finance staff.	We will undertake further checks on material variances reported in the draft RAVs report in line with those undertaken by Audit Scotland to identify errors or anomalies.	Financial Controller February 2017
2	40-46	**Forth Road Bridge asset life** The remaining useful life of the existing Forth Road Bridge is recognised within RAVs as 49 years. This should be revisited following the completion of the next inspection survey of the condition of the cables in 2017 to assess whether the remaining asset life is still appropriate.	This will be undertaken following completion of the survey.	Chief Bridge Engineer April 2018

No.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
3	99-101	**Register of Interests** Given the high level of procurement activity undertaken by the Agency, and the additional risk this potentially exposes staff to of false and / or malicious allegations, we feel the register of interests should be extended to cover other potential conflicts of interests and other key decision making staff within the organisation (e.g. procurement teams). This would provide a more robust process for declaring and registering interests to evidence how these are managed to avoid any real, or perceived, conflicts of interest arising.	Transport Scotland will fully consider the recommendation and in doing so engage with Scottish Government and appropriate staff to formulate proposals which we would expect to be submitted to the Senior Management Team and the Audit and Risk Committee at their winter meeting.	Director of Finance January 2017