Transport Scotland

Interim Audit Report 2016/17

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The Auditor General, the Accounts Commission and Audit Scotland work together to deliver public audit in Scotland:

- The Auditor General is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit the Scottish Government, NHS and other bodies and report to Parliament on their financial health and performance.

- The Accounts Commission is an independent public body appointed by Scottish ministers to hold local government to account. The Controller of Audit is an independent post established by statute, with powers to report directly to the Commission on the audit of local government.

- Audit Scotland is governed by a board, consisting of the Auditor General, the chair of the Accounts Commission, a non-executive board chair, and two non-executive members appointed by the Scottish Commission for Public Audit, a commission of the Scottish Parliament.

About us

Our vision is to be a world-class audit organisation that improves the use of public money.

Through our work for the Auditor General and the Accounts Commission, we provide independent assurance to the people of Scotland that public money is spent properly and provides value. We aim to achieve this by:

- carrying out relevant and timely audits of the way the public sector manages and spends money

- reporting our findings and conclusions in public

- identifying risks, making clear and relevant recommendations.

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Audit findings

Introduction

1. This report details our review of Transport Scotland's key governance arrangements, the conclusions of our interim expenditure testing carried out between December 2016 and March 2017 and discussions with management during that period.

2. Our review of governance arrangements evaluated whether Transport Scotland have sound arrangements in place in key areas including:

- governance framework including standing orders, financial regulations and schemes of delegation

- monitoring business and financial position

- risk management

- corporate and strategic planning

- committee and organisational structure

- information communication technology.

3. The main focus of our interim testing was the verification to source documentation, or other underlying records, of expenditure for material account areas. As the majority of this testing was performed prior to the 2016/17 financial year end, the need for additional testing will be considered as part of the financial statements audit to ensure sufficient audit coverage for the full year is achieved.

4. Given the payment profile of concessionary travel scheme expenditure (i.e. large volume of individual payments) it was not practical to verify a significant proportion of total expenditure through substantive testing of payments. Therefore, the testing approach employed in this area involved confirming the operation of the high-level key controls over the scheme, supplemented by verification testing of interim payments.

Conclusion

5. We have concluded that Transport Scotland have sound governance arrangements in place for those areas within the scope of our review. We have identified three areas where further improvement is required. These are detailed in the section below and in the action plan at Exhibit 2.

6. Our interim testing of expenditure did not identify any errors.

7. The contents of this report have been discussed with relevant officers to confirm factual accuracy. The co-operation and assistance we received during the course of our audit work is gratefully acknowledged.

Governance arrangements

Compliance with EU state aid regulations

8. During our 2014/15 audit we were made aware that a new EU Services of General Economic Interest (SGEI) regulation had come into effect and Transport Scotland was working to adapt its funding arrangements for Highland and Islands Airports Limited (HIAL) to ensure full compliance with the regulation. Since then, Transport Scotland has progressed the issue with HIAL and kept the Scottish Government State Aid Unit and European Commission informed of progress.

9. Our 2015/16 annual audit report highlighted a requirement for Transport Scotland to:

- separate out budgetary provision into allocations for Inverness, Sumburgh and the rest of HIAL

- itemise capital grant claims and for exact amounts

- report HIAL's monthly cash forecast using the Inverness / Sumburgh / rest of HIAL split

- revise HIAL's monthly results package to show a clear disclosure between HIAL's commercial and non-commercial activities.

10. We have confirmed that the first two requirements have been completed. Further progress is required on developing HIAL reporting. Transport Scotland has created a new template for cash forecasting but HIAL has been unable to adopt the template as it is inconsistent with the layout of its financial accounts. More work is required to provide a clear split between HIAL's commercial and non-commercial activities.

11. In 2017/18, Transport Scotland is adopting a new funding model for HIAL. In this model, funds required by HIAL for non-commercial activities will be provided on a loan basis at an interest rate comparable to the commercial market. To facilitate this HIAL is to provide its 2017/18 budget analysed between commercial and non-commercial activities.

12. Transport Scotland is also in the process of adopting a revised framework document setting out the framework within which HIAL operates and defining the key roles and responsibilities underpinning the relationship between both bodies. This document, once finalised, will constitute an Act of Entrustment for SGEI as defined by the European Commission. Transport Scotland has submitted a draft of the revised framework to the European Commission and HIAL for their review and feedback.

13. Management has advised us that the Scottish Government State Aid Unit has been kept informed of the progress being made to comply with the SGEI regulation. Further progress is required to ensure full compliance with state aid rules in 2017/18.

Governance documentation

14. The Transport Scotland framework document which sets out the parameters within which Transport Scotland operate was last reviewed in June 2012. The framework, and supporting corporate and business plans, is likely to require revision to reflect the completion and conclusions of the review of the National Transport Strategy which was announced in August 2016 and is being progressed during 2017.

ICT strategy

15. Transport Scotland's ICT Strategy was published in 2014 and incorporates input from the corporate plan, annual business plan and the ICT meeting group. The needs and requirements of Transport Scotland have changed since 2014 and it is in discussion with the Scottish Government's Information Services and

Information Systems Division (ISIS) to review the best way for ICT to support those needs and facilitate a refresh of the ICT Strategy. It is important that Transport Scotland update their strategy to reflect their current environment and ensure it is focused on delivering their current priorities.

Interim testing

16. To identify account areas for interim testing we reviewed Transport Scotland's budget monitoring spreadsheet and selected those areas of material value to the 2016/17 financial statements. This identified the following areas for testing:

- air services
    - HIAL deficit grants
    - HIAL capital grants
- ferry services
    - vessels and piers
    - CALMAC deficit grant
    - SERCO Northlink grant
- major transport infrastructure projects
    - roads contract works
    - Queensferry crossing
- policy
    - regional transport partnership
    - support for sustainable and active travel
    - transport strategy and innovation
- rail
    - rail franchise (Abellio ScotRail Ltd and Serco Caledonian Sleeper Ltd)
    - rail infrastructure (Network Rail)
- trunk road and bus operations
    - concessionary travel scheme
    - bus services operator grants
    - network strengthening
    - routine and winter maintenance
   - PFI unitary charge (service element)

Audit approach / Level of expenditure verification

17. Transport Scotland's total expenditure for 2016/17 is forecast to be £2.2 billion. Through our testing we have verified a total of 145 expenditure payments totalling £914 million (41% of projected expenditure for the year). The split of this testing across expenditure areas is summarised in Exhibit 1.

18. For the majority of expenditure areas we obtained a listing of transactions to date during 2016/17 and selected large and unusual items for testing. The validity, value and timing of the items were then verified to source documentation (i.e. invoice, requisition form, interim payment certificate, contract, grant award letter, grant claim, or other relevant documents).

19. The two areas where this approach was not adopted were rail infrastructure expenditure and concessionary travel scheme expenditure. The approach adopted for these is explained below.

Exhibit 1: Expenditure verification against budget by material expenditure area
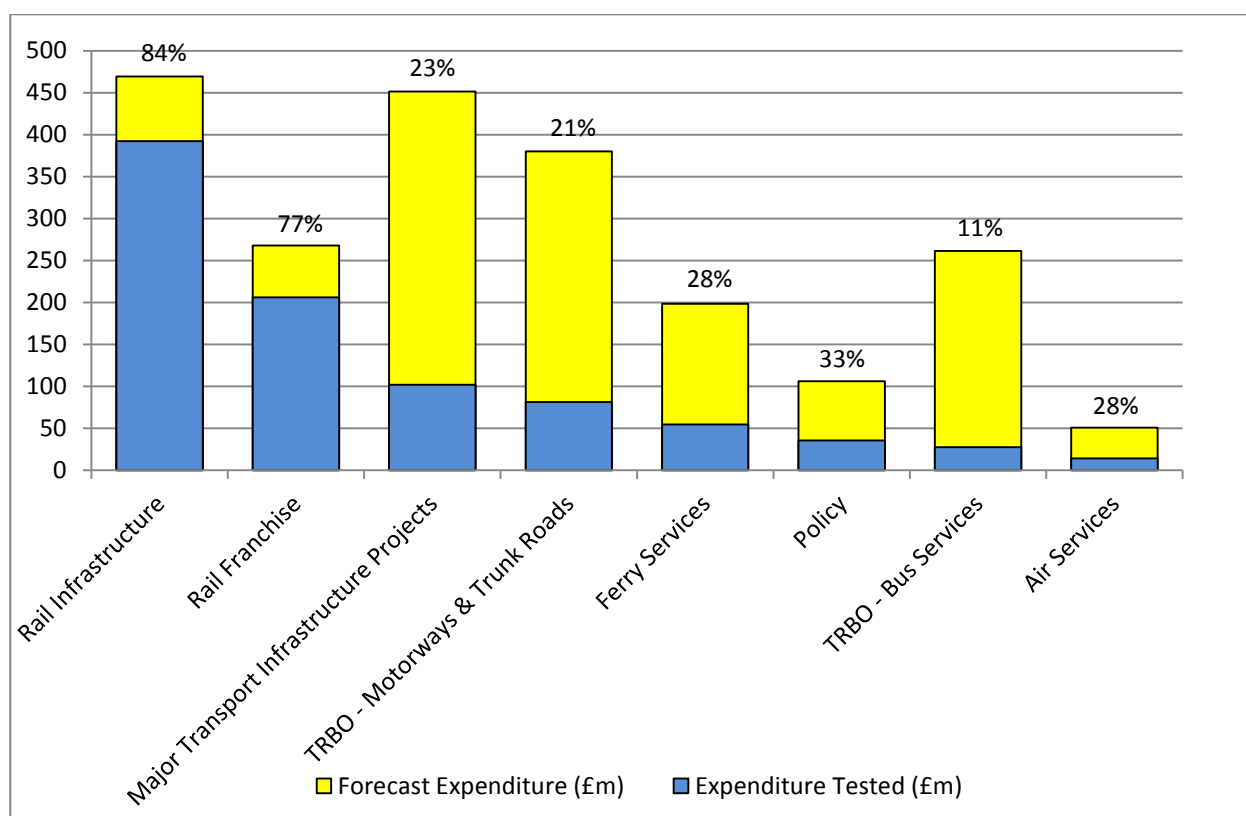
Rail Infrastructure

20. Rail infrastructure expenditure covers the deed of grant payments made to Network Rail under the current franchise agreement. The Office of Rail Regulation (ORR) sets the level of payments to be made. In order to verify the expenditure for the year we agreed the payments made to the amounts set out in the Periodic Review 2013 – Determination of Network Rail's outputs and funding for 2014-19 (adjusted for Retail Prices Index). This confirmed that the payments were in accordance with the amounts advised by the ORR. The total amount payable to Network Rail for the year is split across 13 four-weekly payments of equal value. As a result £392 million (100% of the rail infrastructure expenditure up to the end of period 11 and 84% of total projected expenditure for the year of £463 million) has been verified. The deed of grant payments for periods 12 and 13 will be reviewed as part of the financial statements audit.

Concessionary travel scheme

21. Operators participating in the concessionary travel scheme are reimbursed for eligible journeys at 56.9% of the applicable fare (i.e. 56.9p for each £1). The operators receive reimbursement through payments covering each of the 13 four-weekly payment periods during the year. For each payment period, Transport Scotland makes an interim payment to most operators (generally 90% of the estimated reimbursement value for that period) in advance on the first day of the

period. The balance is paid up to 3 months after the period end, once all validation checks have been completed on the actual claim data for that period.

22. Expenditure under the concessionary fares scheme is capped at £212 million for 2016/17. However, as the current forecast outturn (£189 million as at January 2017) is within this cap, it is not anticipated that Transport Scotland will need to apply the cap. As a result, operators can expect to be reimbursed for all eligible journeys.

23. Given the payment profile of concessionary travel scheme expenditure (i.e. large volume of individual payments) it was not practical for us to verify a significant proportion of total expenditure through substantive testing of payments. Therefore, the testing approach employed in this area combined verification testing of interim payments, with testing of high-level key controls operating over the scheme in 2016/17 as detailed below:

- confirmation that all new operators admitted to the scheme during 2016/17, and a sample of existing operators, held a valid license or equivalent, as issued by the Traffic Commissioner for Scotland

- review of the validity checks performed on a sample of interim operator payments during 2016/17

- verification of a sample of payments made to operators during 2016/17 to the interim calculation spread sheet, and confirmation that interim payment totals agreed to the Scottish Executive Accounting System (SEAS) payment interface.

Issues identified

24. Our interim testing of expenditure did not identify any errors in the expenditure tested.

25. Any issues or weaknesses identified represent those that have come to our attention during the course of normal audit work and therefore are not necessarily all the weaknesses that may exist. It is the responsibility of management to decide on the extent of the internal control system appropriate to Transport Scotland.

Action plan

26. The key governance issues identified and associated action plan are detailed in Exhibit 2.

Exhibit 2
Key findings and action plan 2016/17

Issue identified	Management response	Responsible officer and target date
Audit findings		
Compliance with EU state aid regulations Further progress is required to ensure HIAL's subsidy arrangements for 2016/17 are fully compliant with the requirements of SGEI state aid regulations. **There is a risk of the funding being subject to legal challenge.**	We will continue to take forward and engage with colleagues at HIAL to progress appropriate reporting and disclosure requirements to mitigate risk.	Head of Aviation / Directorate Finance Business Partner March 2018
Governance documentation The Transport Scotland framework document and supporting corporate and business plans are likely to require revision to reflect the completion and conclusions of the review of the National Transport Strategy which is being progressed during 2017. **There is a risk that Transport Scotland's key governance documents may not be aligned to the revised National Transport Strategy.**	The Corporate and Business plans, as well as the framework document are all due to be revised this year. The NTS will not conclude until 2019 so we would expect the next iterations of these documents from 2020 to be aligned with the new NTS.	Director of Finance, Corporate and Analytical Services / Senior Financial Accountant - Finance, Corporate and Analytical Services March 2018
ICT strategy The most recent Transport Scotland ICT Strategy was published in 2014 and requires a refresh to better reflect the current requirements of Transport Scotland. **There is a risk that the ICT Strategy may not be effectively supporting the delivery of Transport Scotland's objectives.**	The ICT Strategy is also due to be revised this year. Again, given that the NTS will not conclude until 2019, we would expect the next iterations of this document to be aligned with the new NTS.	Director of Finance, Corporate and Analytical Services / Senior Financial Accountant - Finance, Corporate and Analytical Services March 2018

Source: Audit Scotland

27. All our outputs and any matters of public interest will be published on our website: www.audit-scotland.gov.uk.

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