

# Transport Scotland

Annual Audit Plan 2016/17



 AUDIT SCOTLAND

Prepared for Transport Scotland  
January 2017

## Who we are

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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# Contents

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<b>Risks and planned work</b>	<b>4</b>
Audit risks	4
Reporting arrangements	6
Audit fee	6
Responsibilities	6
<b>Audit scope and timing</b>	<b>8</b>
Financial statements	8
Adequacy of Internal audit	10
Wider dimension issues and risks	10
Independence and objectivity	15
Quality control	15

# Risks and planned work

1. This annual audit plan contains an overview of the planned scope and timing of our audit and is carried out in accordance with International Standards on Auditing (ISAs), the [Code of Audit Practice](#), and any other relevant guidance. This plan identifies our audit work to provide an opinion on the financial statements and related matters and meet the wider scope requirements of public sector audit. The wider scope of public audit contributes to conclusions on the appropriateness, effectiveness and impact of corporate governance, performance management arrangements and financial sustainability.

## Audit risks

2. Based on our discussions with staff, attendance at committee meetings and a review of supporting information we have identified the following main risk areas for Transport Scotland. We have categorised these risks into financial risks and wider dimension risks. The key audit risks, which require specific audit testing, are detailed in [Exhibit 1](#).

## Exhibit 1

Audit Risk	Management assurance	Planned audit work
<b>Financial statement issues and risks</b>		
<p><b>1 Risk of management override of controls</b></p> <p>ISA 240 requires that audit work is planned to consider the risk of fraud, which is presumed to be a significant risk in any audit. This includes consideration of the risk of management override of controls in order to change the position disclosed in the financial statements.</p>	<p>Not applicable</p>	<p>Detailed testing of journal entries.</p> <p>Review of accounting estimates.</p> <p>Focused testing of accruals and prepayments.</p> <p>Evaluation of significant transactions that are outside the normal course of business.</p>
<p><b>2 Estimation and judgements</b></p> <p>There is a significant degree of subjectivity in the measurement and valuation of the material account areas of non current assets including the trunk road network and assets under construction, provisions and expenditure. This subjectivity represents an increased risk of misstatement in the financial statements.</p>	<p>Year-end capital accruals for assets under construction will be supported by schedules showing basis of calculation noting that in relation to the M8 and AWPR projects to advise that we rely on the contractors to provide us with this information and any underlying evidence.</p> <p>Provisions will be supported by estimates from the most appropriate office and external evidence where relevant.</p> <p>Expenditure accruals will be</p>	<p>Substantive testing of year-end capital accruals.</p> <p>Verification of year end provisions.</p> <p>Substantive testing of year-end expenditure accruals.</p>

Audit Risk	Management assurance	Planned audit work
	supported by schedules showing basis of calculation.	
<p><b>3 Roads network valuation</b></p> <p>In prior years the audit has identified material adjustments to the valuation of the trunk road network valuation. Furthermore, the process used to produce the valuation is complex, involving the application of indexation rates and adjustments to the figures produced by the road asset valuation system (RAVS).</p>	<p>Transport Scotland will engage with audit team to provide an overview of the RAVS system/process including the use of Datacube. This will include engagement with Atkins where this is deemed appropriate.</p> <p>Interim valuation report to be run in February as basis for the draft accounts. This will enable early identification of any required adjustments.</p>	<p>Verify the application of indexation rates and investigate other significant movements in the trunk road network valuation.</p> <p>Interim audit work to review draft road valuation reports.</p> <p>Review the processes and controls in place to manage the roads valuation data.</p>
<p><b>4 Revaluation reserve</b></p> <p>Each year an amount should be released from the revaluation reserve to the general fund to represent the in-year depreciation charge on the trunk road network that is attributable to previous revaluations. In previous years, the audit has identified that this has not taken place and this has resulted in material adjustment to the accounts.</p>	<p>Revaluation reserve adjustments will be processed in the unaudited financial statements and supported by appropriate working papers including the revaluation reserve report provide by Atkins.</p>	<p>Review the relevant accounting entries as part of our 2016/17 financial statements audit.</p>
<p><b>5 EU state aid regulations</b></p> <p>In 2014/15 and 2015/16 we highlighted a potential issue regarding compliance with the EU Services of General Economic Interest (SGEI) regulation in relation to the funding arrangements for Highlands and Islands Airports Limited (HIAL). Assurances were provided that measures were being taken to ensure compliance in 2016/17.</p>	<p>We will continue to consult with the Scottish Government State Aid Unit to ensure arrangements comply with regulations.</p>	<p>Assess the steps taken to ensure compliance with the EU regulation.</p>
<b>Wider dimension risks</b>		
<p><b>6 Financial sustainability</b></p> <p>Transport Scotland, like all public sector bodies, is facing a period of uncertainty in terms of future funding levels. A reduction in the Scottish budget allocation may result in Transport Scotland's budget being reduced going forward. As approximately 90% of Transport Scotland's annual expenditure is contractually committed any budget reduction would place pressure on non-committed budget areas.</p>	<p>Transport Scotland's financial planning is conducted within the context of Scottish Government financial planning with Transport Scotland funded to support the services, contracts and projects approved by Scottish Ministers.</p>	<p>Monitor the Transport Scotland's financial position via budget reports presented to the Audit &amp; Risk Committee.</p> <p>Ongoing monitoring of Transport Scotland's approach to medium and long term financial planning.</p>

## Reporting arrangements

3. Audit reporting is the visible output for the annual audit. All annual audit plans and the outputs as detailed in [Exhibit 2](#), and any other outputs on matters of public interest will be published on our website: [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk).

4. Matters arising from our audit will be reported on a timely basis and will include agreed action plans. Draft management reports will be issued to the relevant officer(s) to confirm factual accuracy.

5. We will provide an independent auditor's report to Transport Scotland and the Auditor General for Scotland that the audit of the financial statements has been completed in accordance with applicable statutory requirements. We will provide the Accountable Officer and Auditor General for Scotland with an annual report on the audit containing observations and recommendations on significant matters which have arisen in the course of the audit.

6. Under the Public Finance and Accountability (Scotland) Act 2000 there is a requirement for the resource account of the Scottish Government to be presented to Parliament within nine months of the financial year-end i.e. 31 December. Transport Scotland's preference is to have the audit process completed by the end of August and we have agreed an audit timetable accordingly.

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## Exhibit 2

### 2016/17 Audit outputs

Audit Output	Target date	Audit & Risk Committee Date
Interim Audit Report	31 March 2017	10 April 2017
Annual Audit Report including ISA 260 requirements	18 August 2017	TBC
Signed Independent Auditor's Report	August 2017	N/A

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## Audit fee

7. The proposed audit fee for the 2016/17 audit of Transport Scotland is £171,030. In determining the audit fee we have taken account of the risk exposure of Transport Scotland, the planned management assurances in place and the level of reliance we plan to take from the work of internal audit. Our audit approach assumes receipt of the unaudited financial statements, with a complete working papers package by 12 June 2017.

8. Where our audit cannot proceed as planned through, for example, late receipt of unaudited financial statements or being unable to take planned reliance from the work of internal audit, a supplementary fee may be levied. An additional fee may also be required in relation to any work or other significant exercises outwith our planned audit activity.

## Responsibilities

### Audit Committee and Accountable Officer

9. Audited bodies have the primary responsibility for ensuring the proper financial stewardship of public funds, compliance with relevant legislation and establishing effective arrangements for governance, propriety and regularity that enable them to successfully deliver their objectives.

**10.** The audit of the financial statements does not relieve management or the Audit & Risk Committee, as those charged with governance, of their responsibilities.

**Appointed auditor**

**11.** Our responsibilities as independent auditor are established by the Public Finance and Accountability (Scotland) Act 2000 and the Code of Audit Practice, and guided by the auditing profession's ethical guidance.

**12.** Auditors in the public sector give an independent opinion on the financial statements. We also review and report on the arrangements within the audited body to manage its performance, regularity and use of resources. In doing this, we aim to support improvement and accountability.

# Audit scope and timing

## Financial statements

**13.** The statutory financial statements audit will be the foundation and source for the majority of the audit work necessary to support our judgements and conclusions. We also consider the wider environment and challenges facing the public sector. Our audit approach includes:

- understanding the business of Transport Scotland and the associated risks which could impact on the financial statements
- identifying major transaction streams, balances and areas of estimation and understanding how Transport Scotland will include these in the financial statements
- assessing the risks of material misstatement in the financial statements
- determining the nature, timing and extent of audit procedures necessary to provide us with sufficient audit evidence as to whether the financial statements are free of material misstatement.

**14.** We will give an opinion on the financial statements as to:

- whether they give a true and fair view of the financial position of Transport Scotland and its expenditure and income
- whether they have been properly prepared in accordance with relevant legislation, the applicable accounting framework and other reporting requirements
- the regularity of the expenditure and income.

## Materiality

**15.** Materiality defines the maximum error that we are prepared to accept and still conclude that that our audit objective has been achieved. It helps assist our planning of the audit and allows us to assess the impact of any audit adjustments on the financial statements. We calculate materiality at different levels as described below. The calculated materiality values for Transport Scotland are set out in [Exhibit 3](#).





## Exhibit 3

### Materiality values

Materiality level	Amount
<b>Planning materiality</b> - This is the calculated figure we use in assessing the overall impact of audit adjustments on the financial statements and represents our judgement about the size of a misstatement that we would consider material. It has been set at 1% of the net book value of the trunk road network as at 31 March 2016 based on the audited 2015/16 accounts.	£171m
<b>Performance materiality</b> - This acts as a trigger point. If the aggregate of errors identified during the financial statements audit exceeds performance materiality this would indicate that further audit procedures should be considered. Using our professional judgement we have calculated performance materiality at 50% of planning materiality specifically in relation to the value of the trunk road network.	£85.5m
As Transport Scotland's total assets balance is more than ten times net operating expenditure, we also set a separate performance materiality level for other assets / liabilities and expenditure. This has been set at 0.75% of gross expenditure and will be applied to all account areas other than the trunk road network.	£12.7m
<b>Reporting threshold</b> - We are required to report to those charged with governance on all unadjusted misstatements in excess of the 'reporting threshold' amount. This has been calculated at 1% of performance materiality but capped at £100,000.	£100k



16. We review and report on other information published with the financial statements including the management commentary, annual governance report and the remuneration and staff report. Any issue identified will be reported to the Audit Committee.

### Timetable

17. To support the efficient use of resources it is critical that a financial statements timetable is agreed with us for the production of the unaudited accounts. An agreed timetable is included at [Exhibit 4](#) which takes account of submission requirements and planned Audit and Risk Committee dates.

## Exhibit 4

### Financial statements timetable

 Key stage	 Date
Latest submission of unaudited financial statements with complete working papers	12 June 2017
Latest date for submission of unaudited consolidation templates	7 July 2017
Latest date for signing of consolidation certificate	14 July 2017
Latest date for final clearance meeting with Director of Finance	21 July 2017
Agreement of audited unsigned financial statements; issue of proposed Annual Audit Report including ISA 260 report to those charged with governance	4 August 2017
Independent auditor's report signed	August 2017
Audit & Risk Committee	21 August 2017

## Adequacy of Internal audit

18. Auditing standards require internal and external auditors to work closely together to make best use of available audit resources. We seek to rely on the work of internal audit wherever possible and as part of our planning process we carry out an assessment of the internal audit function. Internal audit is provided by the Scottish Government Internal Audit Service. As part of our Scottish Government external audit team's planning work they carry out an annual assessment of the adequacy of the internal audit function. We will liaise with our Scottish Government external audit team to confirm that the Internal Audit Service operates in accordance with Public Sector Internal Audit Standards (PSIAS) and has sound documentation standards and reporting procedures in place.

## Areas of reliance

19. Subject to that confirmation, we plan to place reliance on their work in the following areas to support our audit opinion on the financial statements:

- Financial reporting arrangements.

20. In respect of our wider dimension audit responsibilities we also plan to consider other areas of internal audit work including:

- Trunk road maintenance – systems and controls on operation company contract.
- Risk management arrangements.

## Wider dimension issues and risks

21. Our audit is based on four audit dimensions that frame the wider scope of public sector audit requirements as shown in [Exhibit 5](#).

## Exhibit 5

### Audit dimensions



**22.** As part of our risk assessment process we consider each of the four audit dimensions to determine whether there is a need to perform targeted audit work. [Exhibit 6](#) highlights the areas we have considered in relation to Transport Scotland.

## Exhibit 6

### Risk assessment considerations for the audit dimensions

Financial sustainability	Financial management
<ul style="list-style-type: none"> <li>• use of going concern as basis of accounting</li> <li>• financial sustainability in medium/ long term</li> <li>• effectiveness of financial planning in identifying and addressing risks to financial sustainability</li> </ul>	<ul style="list-style-type: none"> <li>• effectiveness of budgetary control system</li> <li>• whether there are comprehensive and current financial regulations</li> <li>• financial capacity and skills</li> </ul>
Governance and transparency	Value for money
<ul style="list-style-type: none"> <li>• governance arrangements are appropriate and operating effectively</li> <li>• effective scrutiny, challenge and transparency in decision-making</li> <li>• quality and timeliness of financial and performance reporting</li> </ul>	<ul style="list-style-type: none"> <li>• value for money in the use of resources</li> <li>• clear link between money spent, output and outcomes delivered</li> <li>• improving outcomes and sufficient focus on improvement</li> </ul>

**23.** Based on our consideration of the wider audit dimensions and to ensure Transport Scotland's operations are subject to appropriate audit coverage, we have developed an indicative long-term audit plan at [Exhibit 7](#) which focuses on the value for money audit dimension. The reviews address three broad areas:

- Operational programmes - we consider whether Transport Scotland is developing programmes which are focused on delivering the strategies agreed by Scottish Ministers and aim to make the best use of available resources.
- Procurement - we consider whether Transport Scotland's procurement arrangements are appropriate and contribute to the achievement of best value.
- Contract performance - we consider whether Transport Scotland is managing and monitoring contracts effectively to ensure that programme objectives are met and value for money achieved. This will take cognisance of the fact that Transport Scotland is managing a range of contracts at various stages of planning, implementation and operation, each with particular objectives and methods of contract monitoring.

**24.** Individual reviews may be linked to more than one of these areas. An indicative plan of wider dimension work over the five year period of the audit appointment is shown in [Exhibit 7](#). Further detail of each of the planned reviews is set out below. The plan is subject to annual review, with the prospect for some areas of planned work to be rescheduled and new ones added as audit risks emerge.

## Exhibit 7

### Indicative long-term audit plan

Audit year	Planned work	Procurement	Contract Performance	Operational Programmes
2016/17	Overview of Ferry Services Prestwick Airport follow-up	✓		✓
2017/18	Roads maintenance impact report Delivery of Queensferry Crossing Review of ScotRail franchise	✓	✓	✓
2018/19	A9 Dualling programme		✓	
2019/20	Delivery of major rail projects		✓	
2020/21	Caledonian Sleeper follow up		✓	

## Operational programmes

### Prestwick airport

**25.** 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. The airport has returned cumulative losses of £17.4 million in the three year period 2013/14 - 2015/16. A revised Prestwick Airport business plan has been approved and will be published subject to consideration by and agreement of Scottish Ministers. We will:

- review the updated business plan from the operator and assess how Transport Scotland has addressed the recommendations made in our 2015 report
- assess the potential impact of the revised business plan on the medium to longer term funding requirements for the airport
- monitor the level and potential for repayment of loan funding support provided by Transport Scotland.

### Roads maintenance impact report

**26.** In August 2016 Audit Scotland published the *Maintaining Scotland's Roads: A follow-up report*. Some key findings highlighted in the report summary are:

- The percentage of trunk roads in acceptable condition declined from 90% in 2011/12 to 87% in 2014/15.
- Transport Scotland expenditure on trunk roads maintenance fell from £168 million in 2011/12 to £162 million in 2014/15 (4% decline). The £162 million spent in 2014/15 was £24 million less (38%) than Transport Scotland considered was necessary to maintain trunk road condition.

**27.** Audit Scotland normally produces an impact report around 12-18 months following publication of a performance audit report, which includes consideration of how public bodies have responded to the original report's recommendations. *Maintaining Scotland's Roads: A follow-up report* contains a number of recommendations for Transport Scotland including:

- Ensure Road Asset Management Plans are used to inform Scottish Ministers of long-term investment plans for maintaining roads that take into account the whole-life costing of treatment options.
- Ensure that the consequences of spending less than that necessary to maintain current road condition adequately features in budget-setting processes to allow Scottish Ministers make informed choices which take account of competing demands and priorities.
- Make road condition information publicly available for the geographical areas of the trunk road network.
- Identify unit cost or other efficiency measures to evaluate the value for money provided by operating companies.
- Consider the overall trend in performance of operating companies and ensure it has appropriate mechanisms in place for addressing areas of poorer performance.
- Fully take account of the needs of the existing trunk road network when considering the affordability of large-scale transport investments taken forward within the Scottish Government's Infrastructure Investment Plan.
- Consider its future strategy for maintaining the trunk road network, including the extent to which council-maintained local roads should be part of contract arrangements.

**28.** Internal Audit is currently carrying out a review of Trunk Roads Maintenance with its conclusions to be reported to the Audit & Risk Committee in January 2017. We will take this report into account when considering how Transport Scotland has responded to *Maintaining Scotland's Roads: A follow-up report* as part of the process of preparing our impact report.

## Procurement

### Overview of Ferry Services

**29.** We are currently carrying out a performance audit of ferry services to assess whether investment in lifeline ferry services is providing value for money. The audit will include a review of the recently-signed contract for the Clyde and Hebrides Ferry Service. It is due for publication in the Autumn of 2017 and will seek to answer the following questions:

- Is there clarity around the operation of subsidised ferry services, including the roles and responsibilities of the different bodies involved?
- How much is spent on subsidised ferry services, what does this achieve and how does Transport Scotland demonstrate that its expenditure is value for money?
- To what extent are Transport Scotland's procurement arrangements for ferry services appropriate and helping to obtain best value?
- Does Transport Scotland have an evidence based strategy for the long-term investment in ferry services and assets?

### Queensferry Crossing

**30.** The Queensferry Crossing, a £1.3 billion project for which construction commenced in the summer of 2011, is in its final year of construction with the bridge currently projected to be opened in May 2017. We will undertake a performance audit of the project during 2017, at least part of which will consider the extent to which it was delivered to time, cost and quality.

## Contract performance

### ScotRail franchise

**31.** A significant part of Transport Scotland's annual expenditure is incurred on the ScotRail passenger franchise awarded to Abellio. During the second half of 2016 there has been extensive media coverage focusing on the performance of the franchise, with particular focus on passenger satisfaction, delays and cancellations. This culminated in a public petition calling for Abellio to be stripped of the ScotRail contract and the Scottish Government giving preliminary consideration as to whether the rail network could return to public ownership. We will monitor developments with the ScotRail passenger franchise during the 2016/17 audit, with a view to undertaking a more detailed review of Transport Scotland's contract performance monitoring arrangements as part of the 2017/18 audit.

### Delivery of rail projects

**32.** Network Rail is expected to exceed the current published projected cost of £742 million to deliver the Edinburgh Glasgow Improvement Project (EGIP). Transport Scotland is currently forecasting a final cost of £802 million and has implemented a process to challenge any further changes to that projection.

**33.** A number of other rail projects have experienced, or are projected to experience, increased costs. These include the Aberdeen to Inverness improvement project, Stirling/Dunblane/Alloa improvements, and Shotts electrification.

**34.** Ernst & Young has concluded a Transport Scotland instigated review to challenge projected cost increases for EGIP, and the other projects named above. Transport Scotland published the E&Y report in October 2016. We will consider the conclusions in this report before determining whether any specific audit work is required.

### Delivery of road projects

**35.** There are four major road projects, at various stages of progression, identified in the Transport Scotland corporate risk register. Each project has a similar risk description which focuses on the risk of not delivering the projects on time and to budget, given the complexity of programme, and environmental, statutory and financial constraints. The A9 dualling programme is the most expensive project with a projected cost of £3 billion. The programme is expected to complete in 2025 with the first phase, dualling between Kincaig and Dalraddy, scheduled for completion in the summer of 2017. Subject to the Auditor General's final approval, we plan to undertake a performance audit in 2018/19 of progress with the A9 dualling project.

### Caledonian Sleeper follow-up

**36.** Our March 2016 report on the Caledonian Sleeper franchise highlighted cumulative losses over the first eight years of the franchise. In 2015/16 we reviewed developments with the Caledonian Sleeper franchise, including a review of the bid evaluation process. This was reported in our 2015/16 annual audit report where we concluded that the approach adopted to assess the viability of the bids was reasonable, and reflected the bid evaluation methodology set out in the Invitation to Tender.

**37.** An updated 2016/17 Caledonian Sleeper Business Plan has been prepared which provides updated financial forecasts to reflect revised key assumptions. The update confirms there is no current improvement to the financial forecasts. We will continue to monitor the performance of the Caledonian Sleeper contract before determining whether any specific audit work is required.

## Independence and objectivity

**38.** Auditors appointed by Audit Scotland must comply with the Code of Audit Practice. When auditing the financial statements auditors must also comply with professional standards issued by the Financial Reporting Council and those of the professional accountancy bodies. These standards impose stringent rules to ensure the independence and objectivity of auditors. Audit Scotland has in place robust arrangements to ensure compliance with these standards including an annual “fit and proper” declaration for all members of staff. The arrangements are overseen by the Assistant Auditor General, who serves as Audit Scotland’s Ethics Partner.

**39.** The appointed auditor and engagement lead for Transport Scotland is Mark Taylor, Assistant Director. Auditing and ethical standards require the appointed auditor to communicate any relationships that may affect the independence and objectivity of audit staff. We are not aware of any such relationships pertaining to the audit of Transport Scotland.

## Quality control

**40.** International Standard on Quality Control (UK and Ireland) 1 (ISQC1) requires that a system of quality control is established, as part of financial audit procedures, to provide reasonable assurance that professional standards and regulatory and legal requirements are being complied with and that the independent auditor’s report or opinion is appropriate in the circumstances.

**41.** The foundation of our quality framework is our Audit Guide, which incorporates the application of professional auditing, quality and ethical standards and the Code of Audit Practice issued by Audit Scotland and approved by the Auditor General for Scotland. To ensure that we achieve the required quality standards Audit Scotland conducts peer reviews, internal quality reviews and is currently reviewing the arrangements for external quality reviews.

**42.** As part of our commitment to quality and continuous improvement, Audit Scotland will periodically seek your views on the quality of our service provision. We welcome feedback at any time and this may be directed to the engagement lead.

# Transport Scotland

## Annual Audit Plan 2016/17

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