

# Transport Scotland

2016/17 Annual Audit Report



 AUDIT SCOTLAND

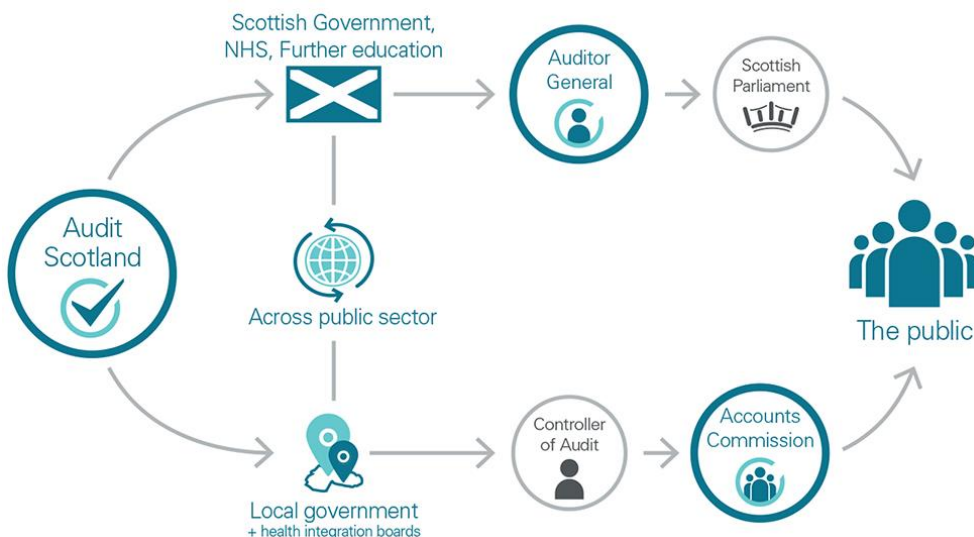
Prepared for Transport Scotland and the Auditor General for Scotland

21 August 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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# Key messages

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## Audit of the 2016/17 financial statements

- 1 Our audit opinions were all unqualified. These covered the financial statements, regularity of transactions, remuneration and staff report, performance report and governance statement.

## Financial management

- 2 Transport Scotland has effective arrangements in place for financial management. It managed its 2016/17 budget well and continues to operate within available resources.
- 3 Transport Scotland prepares clear and concise financial reports on a regular basis which support scrutiny of financial outturn by the Senior Management Team (SMT) and the Audit & Risk Committee (ARC).

## Financial sustainability

- 4 Transport Scotland has appropriate financial planning arrangements in place to support the delivery of its Corporate Plan and identify the medium to long-term impact of spending decisions.

## Governance and transparency

- 5 Transport Scotland has appropriate arrangements in place to support good governance, accountability and scrutiny.
- 6 With increasing public expectations for more openness in the conduct of public business, there is scope for Transport Scotland to review the public availability of relevant SMT and ARC papers and minutes.

## Value for money

- 7 Transport Scotland has an effective performance management framework in place which supports it to deliver continuous improvement.
- 8 Transport Scotland took appropriate action to consider allegations made about BEAR's management of trunk roads maintenance. Its processes and procedures to manage the performance of operating companies are proportionate.

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# Introduction

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1. This report is a summary of our findings arising from the 2016/17 audit of Transport Scotland.

2. The scope of our audit was set out in our Annual Audit Plan presented to the January 2017 meeting of the ARC. This report comprises:

- an audit of the annual report and accounts
- consideration of the wider dimensions set out in the [Code of Audit Practice 2016](#) as illustrated in [Exhibit 1](#).

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## Exhibit 1

### Audit dimensions



Source: Code of Audit Practice 2016

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3. The main elements of our audit work in 2016/17 have been:

- a review of Transport Scotland's key governance arrangements and interim expenditure testing carried out between December 2016 and March 2017
- an audit of Transport Scotland's 2016/17 annual report and accounts including the issue of an independent auditor's report setting out our opinions
- wider dimension work on Transport Scotland's arrangements for financial management, financial sustainability and governance and transparency. In 2016/17 this focused on:

- an assessment of whether investment in lifeline ferry services is providing value for money. We plan to publish a performance audit report on this, on behalf of the Auditor General for Scotland, in the autumn of 2017.
- an initial review of the revised Prestwick Airport business plan issued in May 2017. Given the Scottish Government's long term objective to return the airport to the private sector, we continue to monitor developments in this area and will decide what further audit work is warranted in due course.

**4.** Transport Scotland is responsible for preparing financial statements that give a true and fair view, for the accuracy of the other information in the annual report and accounts, and for establishing effective arrangements for governance, propriety and regularity that enable the board to successfully deliver its objectives.

**5.** Our responsibilities as independent auditor are established by the Public Finance and Accountability (Scotland) Act 2000 and the [Code of Audit Practice 2016](#), supplementary guidance, and are guided by the auditing profession's ethical guidance.

**6.** These responsibilities include giving independent opinions on the financial statements, regularity, the remuneration and staff report, the performance report and the governance statement. We also review and report on the arrangements within Transport Scotland to manage its performance, regularity and use of resources. In doing this, we aim to support improvement and accountability.

**7.** Further details of the respective responsibilities of management and the auditor can be found in the [Code of Audit Practice 2016](#) and supplementary guidance.

**8.** The weaknesses or risks identified in this report are only those that have come to our attention during our normal audit work, and may not be all that exist. Also, our annual audit report contains an action plan at [Appendix 1 \(page 25\)](#). It sets out specific recommendations, responsible officers and dates for implementation.

**9.** Communication in this report of matters arising from the audit of the annual report and accounts or of risks or of weaknesses does not absolve management from its responsibility to address the issues raised, and to maintain an adequate system of control.

**10.** As part of the requirement to provide fair and full disclosure of matters relating to our independence, we can confirm that we have not undertaken non-audit related services. The 2016/17 audit fee for the audit was set out in our Annual Audit Plan and as we did not carry out any work additional to our planned audit activity, the fee remains unchanged.

**11.** This report is addressed to both the board and the Auditor General for Scotland and will be published on Audit Scotland's website [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk).

**12.** We would like to thank all management and staff who have been involved in our work for their cooperation and assistance during the audit.

# Part 1

## Audit of 2016/17 financial statements



### Main judgements

**Our audit opinions were all unqualified. These covered the financial statements, regularity of transactions, remuneration and staff report, performance report and governance statement.**

### Unqualified audit opinions

**13.** The annual report and accounts for the year ended 31 March 2017 will be presented to the ARC for approval on 21 August 2017. We reported, within our independent auditor's report:

- an unqualified opinion on the financial statements
- an unqualified opinion on regularity of expenditure and income
- an unqualified audit opinion on the remuneration and staff report, performance report and governance statement.

**14.** Additionally, we are satisfied that there are no matters which we are required by the Auditor General to report by exception.

### Submission of annual report and accounts for audit

**15.** We received the unaudited financial statements on 12 June 2017, in line with our agreed audit timetable.

**16.** The working papers provided with the unaudited financial statements were of a good standard and finance staff provided support to the audit team which helped ensure the final accounts audit process ran smoothly.

### Risk of material misstatement

**17.** [Appendix 2 \(page 26\)](#) provides a description of those assessed risks of material misstatement that were identified during the planning process which had the greatest effect on the overall audit strategy, the allocation of resources to the audit and directing the efforts of the audit team.

### Materiality

**18.** Materiality defines the maximum error that we are prepared to accept and still conclude that our audit objective has been achieved. The assessment of what is material is a matter of professional judgement. It involves considering both the amount and nature of the misstatement.

**19.** Our initial assessment of materiality for the annual report and financial statements was undertaken during the planning phase of the audit. At the planning

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The annual report and accounts are the principal means of accounting for Transport Scotland's stewardship of its resources and its performance in the use of those resources.

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stage, we set the overall materiality at 1% of the net book value of the trunk road network. Performance materiality was set at 50% of the overall materiality in respect of the trunk road network, and 0.75% of gross expenditure for all other assets, liabilities and expenditure. Specifically with regard to the financial statements, we assess the materiality of uncorrected misstatements, both individually and collectively.

**20.** On receipt of the annual report and accounts we reviewed our original materiality calculations and concluded that they remained appropriate ([Exhibit 2](#)).

## Exhibit 2

### Materiality values

Materiality level	Amount
<b>Overall materiality</b> – This is the calculated figure we use in assessing the overall impact of audit adjustments on the financial statements. It was set at 1% of the net book value of the trunk road network as at 31 March 2017 based on the unaudited 2016/17 accounts.	£175 million
<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 overall materiality, specifically in relation to the trunk road network.	£87.5 million
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 was set at 0.75% of gross expenditure and was applied to all account areas other than the trunk road network.	£12.8 million
<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 was calculated at 1% of overall materiality but capped at £100,000.	£100 thousand

Source: Audit Scotland

## Evaluation of misstatements

**21.** A number of presentational and monetary adjustments to the accounts were identified during the course of our audit. These were discussed with senior finance officers who agreed to amend the financial statements. There are no unadjusted misstatements.

**22.** Identified misstatements arose from the updating of estimations as new information became available, and an error relating to the processing of a £32.7 million Network Rail invoice ([Exhibit 3](#)). As these misstatements were either anticipated or isolated, and no other similar issues were identified during our audit, we concluded that this is not indicative of systematic misstatements within the financial statements.

## Significant findings from the audit

**23.** International Standard on Auditing (UK and Ireland) 260 requires us to communicate significant findings from the audit to you. These are also summarised in [Exhibit 3](#). Where a finding has resulted in a recommendation to management, a cross reference to the Action Plan in [Appendix 1 \(page 25\)](#) has been included.



## Exhibit 3

### Significant findings from the audit of the financial statements

Issue	Resolution
<p><b>1. Road asset valuation system data</b></p> <p>The valuation of the trunk road network as per the unaudited financial statements is based on interim valuation data contained within the roads asset valuation system (RAVS). Once the final valuation data is available there is a need to adjust the financial statements to reflect the movement between the interim and final data sets. Due to the nature of the data, these adjustments are anticipated and normally material in value. In 2016/17 the impact of the movement was a £144.7 million increase in the net book value of the trunk road network which broke down as a £158.6 million increase in revaluations netted against a reduction of £9.8 million in de-trunkings and £4.1 million of historic adjustments.</p>	<p>The audited 2016/17 financial statements have been adjusted to reflect the final valuation.</p>
<p><b>2. Indexation of trunk road network</b></p> <p>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 is not known until mid-July each year and so the figure for Q3 is used in the 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 2016/17 the Baxter index movement between these two quarters increased the net book value of the trunk road network by £17.2 million.</p>	<p>The audited 2016/17 financial statements have been adjusted to reflect the 2016/17 quarter 4 Baxter index figure</p>
<p><b>3. Uplifting of trunk road network land value</b></p> <p>The land on which the trunk road network is constructed is held at gross replacement cost. To calculate the gross replacement cost, rates supplied by the Valuation Office Agency are applied with that value then uplifted by:</p> <ul style="list-style-type: none"> <li>• 81.38% to account for compensation payments that would be involved in the acquisition of new land (within the context of determining a replacement cost)</li> <li>• 20% to account for professional fees that would be incurred in the provision of a replacement asset</li> <li>• 10.22% to account for the legal and agents fees that would be involved in the acquisition of new land.</li> </ul> <p>This is done to reflect the modern equivalent gross replacement cost of the asset, including associated compensation and other costs in line with the objectives of the model.</p> <p>These uplifts add approximately £500 million to the value of the land asset disclosed in the statement of financial position. The 81.38% compensation uplift is an average compensation payment based on a basket of schemes going back to the early 1990s. A similar approach is used</p>	<p>No adjustment required to the 2016/17 financial statements. Consideration will be given to any changes in the methodology used to calculate the uplifts as part of the 2017/18 audit.</p> <p><a href="#">Action Plan (Appendix 1, point 1)</a></p>

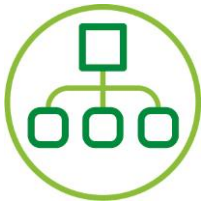
Issue	Resolution
<p>to calculate the other uplifts.</p> <p>We have accepted the explanation and concluded the calculation of the uplifts in 2016/17 was reasonable. However, in our view there is merit in further considering the methodology adopted in 2017/18, including whether the basket of schemes used to calculate the uplifts continues to be appropriate. This should consider recent road construction projects such as the Aberdeen Western Peripheral Route / Balmedie Tippetty which are expected to be more representative of greenfield construction.</p>	
<p><b>4. Overstatement of assets and liabilities</b></p> <p>An error was identified in the processing of a £32.7 million Network Rail invoice relating to 2017/18 which had been processed in the final week of 2016/17. The invoice had been processed as both a year-end trade payables balance and a prepayment balance, neither of which was appropriate as, at the year-end, no balance was due nor had the invoice been paid. While this meant there was a £32.7 million overstatement of both Transport Scotland's year-end assets and liabilities, it should be noted that there was a nil overall impact on the Statement of Comprehensive Net Expenditure for the year or the Statement of Financial Position. We confirmed that the expenditure has been correctly charged to 2017/18.</p>	<p>The audited 2016/17 financial statements have been adjusted to correct the Statement of Financial Position and the movements in working capital in the cash flow statement.</p>
<p>Source: Audit Scotland</p>	

## Other findings

**24.** Transport Scotland has made considerable progress in the previous two years to make its annual report and financial statements more clear and concise. We welcome this development and encourage Transport Scotland to progress this further in 2017/18. In particular, the Performance Report contains a significant amount of description of activities. We consider there are opportunities for Transport Scotland to provide more analysis of performance, including a more detailed assessment of progress against stated objectives. [Action Plan \(Appendix 1, point 2\)](#)

# Part 2

## Financial management



### Main judgements

Transport Scotland has effective arrangements in place for financial management. It managed its 2016/17 budget well and reported a DEL underspend of £53.0 million, 2.5 per cent of its 2016/17 DEL budget of £2.15 billion.

Transport Scotland prepares clear and concise financial reports on a regular basis which supports scrutiny of financial outturn by the SMT and the ARC.

### Financial performance in 2016/17

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

26. Transport Scotland has reported an outturn of £2,097 million, remaining within its overall budget for 2016/17 with an underspend of £53.0 million. The financial performance against Departmental Expenditure Limits (DEL) is shown in [Exhibit 4](#).

### Exhibit 4

Performance against DEL in 2016/17

Performance	Initial budget £m	Final budget £m	Actual outturn £m	Overspend/ (underspend) £m
Resource DEL	1,628.2	1,631.1	1,622.0	(9.1)
Capital DEL	503.6	518.6	474.7	(43.9)
Total DEL	2,131.8	2,149.7	2,096.7	(53.0)

Source: Transport Scotland

27. [Exhibit 5](#) shows how the £53.0 million DEL underspend is split across the main areas of expenditure. The most significant variation between outturn spend and final budget relates to motorways and trunk roads (outturn of £717.1 million against a final budget of £759.6 million). Transport Scotland largely attributes this to lower than expected outturn in respect of the Forth Replacement Crossing, which is managed on a corporate basis by Scottish Government. The saving contributes to the overall balancing of expenditure within the Scottish budget as a whole. In most areas of expenditure, outturn was within six per cent of final budget.

## Exhibit 5

### Performance against DEL by expenditure area

Expenditure area	Final budget £m	Actual outturn £m	Overspend/ (underspend) £m	Overspend/ (underspend) %
Rail services	740.4	737.9	(2.5)	(0.3)
Concessionary travel	261.3	250.2	(11.1)	(4.2)
Motorways and trunk roads	759.6	717.1	(42.5)	(5.6)
Ferries	198.6	209.6	11.0	5.5
Air	50.8	48.1	(2.7)	(5.3)
Other transport	96.8	93.2	(3.6)	(3.7)
Scottish Futures Fund	20.3	18.9	(1.4)	(6.9)
Local authority grants	21.9	21.7	(0.2)	(0.9)
<b>Total</b>	<b>2,149.7</b>	<b>2,096.7</b>	<b>(53.0)</b>	<b>(2.5)</b>

Source: Transport Scotland

**28.** In addition to the DEL budget detailed above, Transport Scotland was also allocated Scottish Budget Outside Departmental Expenditure Limit (ODEL) of £87.6 million for PFI resource (PFI service and interest charges paid in year) and £157.0 million for PFI capital (cost of PFI capital works undertaken that is recognised as an asset during the construction phase). During the year there was an underspend of £14.4 million against the PFI resource budget and a small underspend of £0.3 million against the PFI capital budget.

### Budgetary processes

**29.** We considered Transport Scotland's budgetary processes and budget monitoring arrangements by reviewing budget monitoring reports and committee papers and attending ARCs. The Director of Finance, Corporate and Analytical Services produces regular budget monitoring reports which are scrutinised monthly by the SMT, and quarterly by the ARC. These reports provide clear and concise high-level information but are sufficiently detailed to highlight any significant projected underspends or overspends, or other areas for attention.

**30.** We concluded that Transport Scotland has sound budgetary monitoring and control arrangements that allow both members and officers to carry out effective scrutiny of its finances.

### Prevention and detection of fraud and irregularity

**31.** We assessed Transport Scotland's arrangements for the prevention and detection of fraud. This included reviewing Transport Scotland's Fraud Policy & Response Plan, whistleblowing policy, 2016/17 fraud log and the conclusions of internal audit's 2014/15 review of the Concessionary Fare Fraud Policy & Fraud Strategy. We concluded that Transport Scotland had appropriate and adequate

Financial management is about financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.

arrangements in place for fraud detection and prevention during 2016/17. Transport Scotland identified no cases of fraud in 2016/17.

### **National Fraud Initiative**

**32.** The National Fraud Initiative (NFI) in Scotland is a counter-fraud exercise coordinated by Audit Scotland. It uses computerised techniques to compare information about individuals held by different public bodies, and on different financial systems, to identify 'matches' that might suggest the existence of fraud or error.

**33.** Central government public bodies are required to provide data on payroll and trade creditors as part of the NFI. However, the Scottish Government is responsible for investigating payroll and creditor data for bodies, including Transport Scotland, that use Scottish Government systems for those functions. External auditors are currently finalising their review of the Scottish Government's arrangements under the NFI. This is expected to contribute to Audit Scotland publishing a report on the NFI later in 2018.

### **Standards of conduct and arrangements for the prevention and detection of bribery and corruption**

**34.** We have reviewed the arrangements in place to maintain standards of conduct including the Civil Service Code and Whistleblowing Policy. We concluded that Transport Scotland has appropriate arrangements in place for the prevention and detection of bribery and corruption.

# Part 3

## Financial sustainability



### Main judgements

**Transport Scotland has appropriate financial planning arrangements in place to support the delivery of its Corporate Plan and identify the medium to long-term impact of spending decisions.**

#### Financial planning

**35.** Transport Scotland has an allocated DEL budget of £2.23 billion for 2017/18, comprising resource DEL of £1.67 billion and capital DEL of £560 million. This is comparable with the final 2016/17 budget of £1.63 billion of resource DEL and £519 million of capital DEL. Transport Scotland is not currently forecasting any AME in 2017/18. There is currently no budget allocated for ODEL capital, although expenditure of £5 million is forecasted against this budget line. In line with previous years, management anticipates that the Scottish Government will allocate an additional ODEL capital budget as part of the Autumn Budget Revision.

**36.** Transport Scotland currently forecasts it will manage its 2017/18 expenditure within the HM Treasury fiscal DEL budget and for an underspend on the ring-fenced DEL budget. It continues to operate within its available funding and we have no concerns over its short term financial position.

#### 2016/17 financial position

**37.** The Statement of Financial Position summarises what is owned, due to and owed by Transport Scotland. This shows taxpayers' equity – an accounting measurement of the amount invested that has continuing public benefit. It shows how much of this has arisen from the application of revenues and that which has resulted through changes over time in the value of physical assets.

**38.** The financial statements show that Transport Scotland has:

- an excess of assets over liabilities, with net assets of £19.1 billion due primarily to the £17.9 billion net book value of the trunk road network
- a shortfall in current assets against current liabilities of £171.3 million. This is attributable to Transport Scotland not carrying any cash reserves, as the Scottish Government provides funding on a cash basis as required.

**39.** We are satisfied that Transport Scotland's current financial position is stable.

#### Medium to long term financial planning

**40.** Transport Scotland does not undertake significant income generating activities and is predominantly funded via the Scottish Government budget allocation which is set on a year-on-year basis. In addition, approximately 90% of Transport Scotland's annual expenditure is contractually committed. This means that

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Financial sustainability looks forward to the medium and longer term to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.

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Transport Scotland has limited scope for reducing expenditure or increasing income over the short term.

**41.** We considered the financial planning systems and assessed how Transport Scotland identifies risks to financial sustainability across the medium and long term. Transport Scotland maintains a long term financial plan which forecasts budget requirements for the next ten years based on current spending programmes and contractual commitments. This helps identify the medium to long term impact of spending decisions and potential future budget pressures.

# Part 4

## Governance and transparency



### Main judgements

**Transport Scotland has adequate arrangements in place to support good governance, accountability and scrutiny.**

**With increasing public expectations for more openness in the conduct of public business, there is scope for Transport Scotland to review the public availability of relevant SMT and ARC papers and minutes.**

**Internal audit operates in accordance with the Public Sector Internal Audit Standards and considered that Transport Scotland's control framework continues to provide substantial assurance.**

### Governance arrangements and transparency

**42.** Transport Scotland's SMT, comprising the executive directors, is the senior management monitoring and decision making forum within the agency, and has overall responsibility the organisation's corporate governance. The ARC, on which there are three non-executive members, and established project boards, to oversee delivery of major infrastructure projects, provide governance support to the SMT. The governance arrangements are well established and support effective working relationships.

**43.** Unlike other executive agencies, Transport Scotland has operated without non-executive director membership of a board as the main decision making forum since 2010/11. When changing to this structure, Transport Scotland took the view that the board, as it then existed, provided limited added value as Scottish Ministers have authority over Transport Scotland's policy and functions. Therefore, there was limited scope for non-executive directors to provide creative challenge or influence. This remains the current position.

**44.** Transparency means that stakeholders, including the public, have access to understandable, relevant and timely information about how a public body is taking decisions and how it is using public resources. Meetings of the SMT and the ARC are not open to the public and, while minutes of SMT meetings are made available via the Transport Scotland website, the supporting papers are not. In relation to the ARC, neither the papers nor minutes are publicly available on the Transport Scotland website. Due to the confidential and sensitive nature of some of the discussions held it is recognised that it would be inappropriate to publish all SMT and ARC papers.

**45.** With increasing public expectations for more openness in the conduct of public business, there is scope for Transport Scotland to review the public availability of relevant SMT and ARC papers and minutes.

Governance and transparency is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision-making and transparent reporting of financial and performance information.



## The Annual Governance Statement

**46.** Under the Treasury's Financial Reporting Manual (FRM), Transport Scotland must prepare an annual governance statement within the Annual Report and Accounts. Guidance is set out within the Scottish Public Finance Manual (SPFM) for the content of the statement and provides assurances around the achievement of the organisation's strategic objectives.

**47.** The SPFM does not prescribe a format for the annual governance statement, but sets out minimum requirements for central government bodies. Within Transport Scotland each of the six directors provides the Accountable Officer with certificates of assurance together with completion of an internal control checklist covering areas of corporate governance.

**48.** We concluded that the annual governance statement 2016/17 complies with the guidance issued by the Scottish Ministers and, based on our knowledge and work performed, presents a comprehensive picture of governance arrangements.

## Internal audit

**49.** Internal audit provides Transport Scotland's accountable officer with independent assurance on the overall risk management, internal control and corporate governance processes.

**50.** The internal audit function is carried out by the Scottish Government Internal Audit Directorate. As part of our risk assessment and planning process, the Scottish Government external auditors carried out a review of the adequacy of the internal audit function. The external auditors concluded that internal audit operates in accordance with the Public Sector Internal Audit Standards (PSIAS).

**51.** To avoid duplication of effort, we seek to place reliance on the work of internal audit where possible. In 2016/17, for the purpose of obtaining assurance for our financial statements work, we had planned to place formal reliance on internal audit's work on financial reporting arrangements. However, internal audit did not carry out the review in 2016/17. We increased our sample sizes to compensate for the review not taking place in order to obtain the necessary assurances over Transport Scotland's financial statements.

**52.** We also considered the findings from internal audit's review of trunk road maintenance and risk management arrangements as part of our wider dimension work.

## Risk management

**53.** As part of our planning work, we performed a high level review of Transport Scotland's risk management arrangements, including a review of the updated risk management framework and the corporate and directorate risk registers. We confirmed that the arrangements were appropriate.

**54.** In March 2017, internal audit issued a report on Transport Scotland's risk management arrangements and provided an overall 'substantial assurance' opinion. This means internal audit was of the view that the controls in place are robust and well managed.

# Part 5

## Value for money



### Main judgements

**Transport Scotland has an effective performance management framework in place which supports it to deliver continuous improvement.**

**Transport Scotland took appropriate action to consider allegations made about BEAR's management of trunk roads maintenance. Its processes and procedures to manage the performance of operating companies are proportionate.**

### Performance management

**55.** Accountable officers have a specific responsibility to ensure that arrangements have been made to secure Best Value. The Auditor General may require that we consider whether accountable officers have put in place appropriate arrangements to satisfy their corresponding duty of Best Value. Where such requirements are not specified we may, in conjunction with Transport Scotland agree to undertake local work in this area.

**56.** The performance of Transport Scotland is monitored by the SMT during monthly management team meetings. A standing agenda item considers current progress against major projects such as:

- Forth Replacement Crossing
- Edinburgh Glasgow Improvement Programme (EGIP)
- Rail enhancements
- M8 M743 M74
- Aberdeen Western Peripheral Route / Balmedie Tippetty (AWPR/B-T)

**57.** The SMT also considers updates on areas of operational performance for rail, road, ferries and concessionary travel/bus support, as well as indicators relating to finances, payment performance, efficiencies, resourcing and sickness levels.

**58.** We concluded that Transport Scotland has effective performance management measures in place. The SMT is kept well informed of performance across all areas of activity. This helps support the achievement of value for money and continuous improvement in the way services are delivered.

### ScotRail franchise

**59.** Transport Scotland awarded the ScotRail passenger franchise to Abellio in October 2014. The contract is expected to be worth around £7 billion over 10

Value for money is concerned with using resources effectively and continually improving services.

years. During the second half of 2016 there was extensive media coverage focusing on Abellio's delivery of the ScotRail franchise, with particular focus on passenger satisfaction, delays and cancellations. This culminated in a public petition calling for the contract to be re-tendered. In November 2016 the ScotRail Alliance published a 249 point Performance Improvement Plan (PIP) designed to improve overall train performance and provide a foundation to deliver continuous improvement in punctuality in future. The targeted completion dates assigned to the 249 action plan points ranged from September 2016 to December 2018.

**60.** Transport Scotland monitors ScotRail's delivery of the PIP initiatives through informal and formal meetings, weekly reporting and site visits. This includes:

- ScotRail provide Transport Scotland with a weekly PIP Scorecard which specifies the total number of actions open/ completed and overdue.
- Transport Scotland meet ScotRail fortnightly to review the actions contained on the scorecards, challenge overdue actions and discuss any potential risks to delivery.
- Four weekly meetings between Transport Scotland and ScotRail at which ScotRail present the progress against the PIP.
- Regular communications between Transport Scotland and ScotRail on specific PIP actions related to Fleet, Infrastructure or Operations.
- Ad-hoc site visits by Transport Scotland to review new infrastructure installed as part of the PIP.

**61.** It is too early to assess whether the ongoing delivery of the plan is resulting in the desired increase in overall performance. We intend to perform a review of Transport Scotland's contract performance monitoring arrangements as part of the 2017/18 audit with a specific focus on the ScotRail franchise.

## Delivery of rail projects

**62.** As a result of concerns about projected cost increases, Transport Scotland appointed Ernst & Young (E&Y) in May 2016 to investigate the management of major rail projects in Scotland by Network Rail. Major rail projects affected included the EGIP, Aberdeen to Inverness improvement project, Stirling/Dunblane/Alloa improvements and Shotts electrification. E&Y finalised its report in October 2016, and Transport Scotland is continuing to work with Network Rail to deliver the improvement plan arising from the E&Y review.

**63.** Transport Scotland monitors progress against these rail projects at the monthly SMT meetings. It has also implemented additional governance arrangements to scrutinise progress, including establishing a major rail projects portfolio board and establishing clear terms of reference for each joint governance forum specific to major rail projects.

**64.** The portfolio board is planning to carry out an independent review of progress against the implementation of the recommendations in the improvement plan. This would include an assessment of the additional governance arrangements. Transport Scotland will commission the review in due course.

**65.** While these additional governance arrangements have the potential to enhance scrutiny and accountability, rail projects are continuing to experience delays and cost increases. For example:

- The start date of the first electric services on EGIP has slipped to October 2017 from its original date of December 2016, subsequently revised to July 2017. This is primarily due to issues with electrification which are projected to increase costs by approximately £66 million from the £795 million

projection at the time of the E&Y review. There may be further increases associated with the delay to the introduction of electric services to October 2017.

- Stirling / Dunblane / Alloa costs are projected to increase from approximately £167 million to approximately £195 million. The introduction of electric services by December 2018 is now considered unrealistic and slippage to March 2019 is expected.

**66.** Our 2016/17 annual audit plan included an indicative long-term audit plan covering 2016/17 to 2020/21. This provisionally timetabled a review of the delivery of major rail projects as part of the 2019/20 audit. We will consider whether this timing is still appropriate as part of our planning approach to the 2017/18 audit and provide an update in our 2017/18 annual audit plan.

## BEAR allegations

**67.** In early 2015, former employees made allegations concerning BEAR Scotland Ltd's performance in carrying out trunk roads maintenance on behalf of Transport Scotland in the North East area. The allegations were centred mainly on works delivered from BEAR's Dundee Depot. In response to these allegations, Transport Scotland instructed PAGplus (who evaluate the quality of trunk road maintenance work) to undertake further investigatory work to determine what evidence, if any, existed to support the allegations made.

**68.** Senior Transport Scotland staff gave evidence to the Public Audit and Post-Legislative Scrutiny Committee on 19 January 2017, as part of its consideration of our performance audit report *Maintaining Scotland's roads: A follow-up report*. During the session, the Committee's convener explored how Transport Scotland had investigated the allegations made. We reviewed how Transport Scotland had responded to the allegations made against BEAR Scotland Ltd. [Exhibit 6](#) sets out the objectives we considered and our findings against each objective.

## Exhibit 6

### Consideration of Transport Scotland's investigation of allegations concerning BEAR

Audit Objective	Findings
How has Transport Scotland assured itself that such process failings have not occurred in the other trunk roads maintenance operating contracts?	Transport Scotland commissioned PAGplus to assess the allegations made in relation to BEAR's performance in the North East area. PAGplus also reviewed the North West Unit (also BEAR) which identified similar issues as those identified for the North East unit. In addition, PAGplus examined a coring exercise on patching in the South West and South East units and found no evidence of work which could not be fully justified.
What action has Transport Scotland taken in response to the findings of the PAGplus investigation, and how has it confirmed that operating companies have implemented any additional guidance issued?	While PAGplus's investigations determined that there was no systematic fraud perpetrated by BEAR, it found evidence of <ul style="list-style-type: none"> <li>• Work being done that was incorrectly documented and inaccurately recorded by BEAR.</li> <li>• BEAR charging for work that was not undertaken and, to a lesser extent, not charging for work which it did undertake.</li> <li>• The controls which BEAR should have to deliver the contracts were either not in place or were not properly enforced by it.</li> </ul>

Audit Objective	Findings
	<p>PAGplus concluded that, overall, Transport Scotland paid BEAR £280,000 which was not fully justified. This money has now been recovered.</p> <p>In response to PAGplus' findings, Transport Scotland provided all operating companies with additional guidance on the level of data that is required to be gathered during the preparation and delivery of patching operations.</p> <p>Specifically for BEAR, a 13 point improvement plan was put in place (initiated by BEAR). Transport Scotland is monitoring progress against each improvement action.</p> <p>Transport Scotland also asked internal audit to review the controls in place to manage the risks relating to the efficient and effective management of trunk road maintenance. Internal audit reported its findings to the ARC and concluded that the risk, governance and control procedures in place are effective.</p>
<p>How is Transport Scotland addressing any areas of under-performance in the delivery of trunk road maintenance operations?</p>	<p>Transport Scotland and the operating companies attend monthly management meetings to review progress against agreed programmes of work. This allows any potential issues which arise to be addressed. Partner and Leadership Boards have been established and meet quarterly to discuss performance and contract progression. There is a separate board for each of the operating companies and representatives of Transport Scotland and the operating companies sit on them.</p> <p>PAGplus monitors the performance of operating companies, and undertakes an annual programme of audits of roads maintenance work activity. Audit reports are issued to the operating companies and Transport Scotland. On a quarterly basis, PAGplus provides Transport Scotland with a performance report on the operating companies and meets with Transport Scotland to discuss the report. PAGplus also provides an annual performance report on the operating companies which is publically available.</p>

Source: Audit Scotland

**69.** Based on the work carried out, we have concluded that Transport Scotland acted appropriately to consider whether the process failings highlighted in the North East unit were not replicated in the other operating contracts. We also concluded that Transport Scotland took appropriate measures in response to the findings of PAGplus' investigation, and that procedures are in place to monitor and manage the performance of operating companies on an ongoing basis. We consider that the processes and procedures in place are proportionate.

### Glasgow Prestwick Airport follow-up

**70.** Audit Scotland published a performance audit report in February 2015 on the Scottish Government's purchase of Glasgow Prestwick Airport (GPA). One of the report's key recommendations was that a clear strategy should be put in place for the airport, 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.

**71.** In 2016, TS Prestwick Holdco Limited, who are responsible for the ownership and operation of GPA, finalised a new executive team with a new Chief Executive Officer appointed in May 2016. The Holdco board subsequently approved a revised

2017-2022 strategic plan for GPA, which was published in April 2017. We have carried out audit work to:

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

**72.** Since the purchase of GPA in November 2013, TS Prestwick Holdco Limited has returned cumulative losses of £26.5 million in the period to March 2017. Over the same period, Transport Scotland's loan support has increased to £30.4million. This is summarised in [Exhibit 7](#).

## Exhibit 7

### TS Prestwick Holdco Limited – summary financial performance 2013/14-2016/17

	17 month period ending 31/03/15 £m	2015/16 £m	2016/17 £m	Cumulative £m
Gross loss	10.1	7.2	6.3	23.6
Operating loss	8.4	8.7	7.8	24.9
Loss for financial year	8.7	9.2	8.6	26.5
Loan outstanding	10.8	20.8	30.4	30.4

Source: TS Prestwick Holdco Limited audited annual accounts 2014/15 – 2016/17

**73.** The revised strategic plan sets out a range of options for developing GPA, each with revenue and cost projections based on assumptions of growth in passenger numbers, freight, property income and fixed base operations. While the base assumptions in the revised plan are lower than in previous plans, they still appear optimistic. For example, over the five year period of the plan, the base assumptions include:

- 77% increase in passenger numbers
- 32% increase in freight tonnage
- 111% increase in revenue with 36% increase in costs.

**74.** During 2016/17, GPA performed well against its projected passenger numbers, freight, revenue and costs. Overall, the loss for the financial year was £0.46 million less than projected. In the first quarter of 2017/18, GPA's revenue has continued to exceed the amount budgeted in most areas. However, costs have also been higher than anticipated due to additional non-recurring costs, particularly for agency costs

to cover staff illness and injury. Based on results to date, GPA is still anticipating an overall loss £0.27 million less than budgeted for 2017/18 as a whole.

**75.** While GPA did identify risks to the delivery of the options set out in the strategic plan the financial planning for all four are based on projected growth. Although GPA performed well in 2016/17 against its projected passenger numbers, freight, revenue and costs, there is yet insufficient evidence to support the projected growth that is required for GPA to achieve its preferred development option.

**76.** As the airport begins to deliver its five year strategic plan for 2017-2022, we will continue to monitor developments and will provide a further update as part of our 2017/18 audit.

## Overview of ferry services

**77.** 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 includes a review of the contract for the Clyde and Hebrides Ferry Service 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?

**78.** We plan to publish our conclusions on this work in the autumn of 2017.

## Good practice

**79.** Transport Scotland are in the process of developing a methodology and assessment tool to enable it to prioritise future spending decisions and assess the impact of its spending against Scottish Government objectives. It intends to use its Policy Assessment Framework (PAF) tool to assess how projects perform against Scottish Government policies such as:

- promotion of economic growth
- improving integration
- protecting the environment and improving health
- improving journey safety
- promoting special inclusion.

**80.** Transport Scotland has already assessed 42 existing programmes against the PAF and concluded that it provided a useful mechanism for analysing programmes and comparing the impact of spending on a consistent basis. Transport Scotland now plans to incorporate the PAF into Investment and Decision Making guidance, while recognising that the PAF may need to be revised once the outcomes of the current National Transport Projects Review become clear.

## National performance audit reports

**81.** Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2015/16, we published a number of reports which are of direct interest to Transport Scotland. These are outlined in [Appendix 3](#) accompanying this report.



# Appendix 1

## Action plan 2016/17

### 2016/17 recommendations for improvement

Page no.	Issue/risk	Recommendation	Agreed management action/timing
9	<p><b>1. Uplifting of trunk road network land value</b></p> <p>The value of land on which the trunk road network is constructed is uplifted by approximately £500 million to account for compensation payments, professional fees and legal/agent fees. The uplift percentages applied are based on a basket of schemes going back to the early 1990s.</p> <p><b>Risk</b></p> <p>The uplift percentages applied may no longer reflect the expenditure which could reasonably be expected to be incurred during the acquisition of new land.</p>	<p>Consideration should be given to whether the basket of schemes used to calculate the uplift percentages is still appropriate.</p>	<p>Agreed – we will review any relevant updated information available in the following year to consider whether it should be incorporated in a revised basket of schemes to determine the percentage uplift to be applied to land valuations.</p> <p>Responsible officer – Head of Management Information Systems</p> <p>Agreed date - January 2018</p>
10	<p><b>2. Content of the Annual Report</b></p> <p>There are opportunities for Transport Scotland to review how the annual report could be made more informative. In particular, the content of the performance report could provide more analysis of performance, including a more detailed assessment of progress against stated objectives.</p> <p><b>Risk</b></p> <p>A more detailed analysis of performance would help Transport Scotland demonstrate greater public accountability and transparency.</p>	<p>Consideration should be given to how annual report could be enhanced to be more informative and demonstrate better Transport Scotland's performance against objectives.</p>	<p>Agreed. While much work has already been done on improving the layout and transparency of the documents, it is agreed that there is scope for further improvement. The Financial Accounting Team have already committed to an exercise in 2017-18, which will fully review the layout, content and presentation of the Annual Report and Accounts. A sub team will be set up to do this in the latter part of 2017.</p> <p>Responsible officer - Senior Financial Accountant</p> <p>Agreed date - September 2017-February 2018</p>

# Appendix 2

## Significant audit risks identified during planning

The table below sets out the audit risks we identified during our planning of the audit and how we addressed each risk in arriving at our conclusion. The risks are categorised between those where there is a risk of material misstatement in the annual report and accounts and those relating to our wider responsibility under the [Code of Audit Practice 2016](#).





















Audit Risk	Assurance procedure	Results and conclusions
<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>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>Prepayments were overstated by £32.7 million. However, this was due to a bookkeeping error and not an override of controls. See page 10 for further details.</p> <p>No other issues were identified.</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>Substantive testing of year-end capital accruals.</p> <p>Verification of year-end provisions.</p> <p>Substantive testing of year-end expenditure accruals.</p>	<p>No issues identified.</p>
<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>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>An adjustment of £17.2 million was required to reflect the Baxter's Q4 indexation (see page 9 for more details).</p> <p>It was not possible to perform interim audit work due to the availability of the necessary information. All testing was performed during the final accounts work.</p> <p>No other issues identified.</p>

Audit Risk	Assurance procedure	Results and conclusions
<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>Review the relevant accounting entries as part of our 2016/17 financial statements audit.</p>	<p>The adjustment was appropriately made in the unaudited 2016/17 financial statements.</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>Assess the steps taken to ensure compliance with the EU regulation.</p>	<p>An update was reported in our interim report issued to the ARC in April 2017. We concluded that further progress is required to ensure HIAL's subsidy arrangements are fully compliant with the requirements of SGEI state aid regulations.</p>
<p><b>Risks identified from the auditor's wider responsibility under the Code of Audit Practice</b></p>		
<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>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>	<p>Transport Scotland continues to operate within its available funding and has an appropriate approach to medium and long term financial planning. We have no concerns over its short to medium term financial position.</p>

# Appendix 3

## Summary of national performance reports 2016/17



Apr			
May		Common Agricultural Policy Futures programme: an update	
Jun		South Ayrshire Council: Best Value audit report	 The National Fraud Initiative in Scotland
Jul		Audit of higher education in Scottish universities	 Supporting Scotland's economic growth
Aug		Maintaining Scotland's roads: a follow-up report	 Superfast broadband for Scotland: a progress update
			 Scotland's colleges 2016
Sept		Social work in Scotland	 Scotland's new financial powers
Oct		Angus Council: Best Value audit report	 NHS in Scotland 2016
Nov		How councils work – Roles and working relationships in councils	 Local government in Scotland: Financial overview 2015/16
Dec		Falkirk Council: Best Value audit report	 East Dunbartonshire Council: Best Value audit report
Jan			
Feb		Scotland's NHS workforce	
Mar		Local government in Scotland: Performance and challenges 2017	 i6: a review
			 Managing new financial powers: an update

### The following reports may be of particular interest:

[Supporting Scotland's economic growth](#) – July 2016

[Maintaining Scotland's roads: a follow-up report](#) – August 2016

[Superfast broadband for Scotland: a progress update](#) – August 2016

[Scotland's new financial powers](#) – September 2016

[Managing new financial powers: an update](#) – March 2017

# Transport Scotland

## 2016/17 Annual Audit Report

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Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN  
T: 0131 625 1500 E: [info@audit-scotland.gov.uk](mailto:info@audit-scotland.gov.uk)  
[www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk)