Transport Scotland

Report on the 2009/10 audit to Transport Scotland and the Auditor General for Scotland

November 2010

Audit Scotland

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Contents

Key messages

In 2009/10 we looked at the key strategic and financial risks being faced by Transport Scotland. We audited the financial statements and we also reviewed the use of resources and aspects of governance and performance management. This report sets out our key findings.

Financial statements

We have given an unqualified opinion on the financial statements of Transport Scotland for 2009/10. We have also concluded that in all material respects, the expenditure and receipts shown in the financial statements were incurred or applied in accordance with applicable enactments and relevant guidance, issued by Scottish Ministers.

Transport Scotland has made good progress in implementing International Financial Reporting Standards (IFRS). There are challenges going forward with the need to account for the merged functions of Transport Scotland and the Transport Directorate of the Scottish Government; and we have agreed there should be a dry run exercise to take stock of this and other accounting developments.

Financial position and use of resources

The net outturn for 2009/10 was £2,217 million against a resource budget of £2,261 million, a net under spend of £44 million. Net operating costs for the year were £1,908 million (2008/09: £1,864 million) and net capital expenditure of £309 million (2008/09: £193 million). Net assets at 31 March 2010 were £15,643 million (2008/09: £14,848 million).

As part of our report, we confirm expenditure and other details in relation to two high profile projects: Edinburgh Trams and the Glasgow Airport Rail Link.

For 2010/11, Scottish Ministers have agreed a budget for Transport Scotland of £2,228 million, a decrease of £33 million. This is for existing functions (excluding the transfer of budget for Transport Directorate functions).

Transport Scotland has been expected to achieve 2% of efficiency savings per year. This translated into a target of £150 million for the three years to 2010/11; Transport Scotland's Annual Report records progress in achieving this target through a range of measures.

The public sector is under the greatest financial pressure since devolution ten years ago. It will be very challenging to maintain current levels of public services and meet new demands when resources are tight. It remains unclear what impact the current recession will have beyond 2010/11. The Scottish budget is likely to reduce in real terms but the full extent of this is not yet known. Two per cent efficiency savings will not be sufficient beyond 2011 to bridge the gap between public spending trends and the smaller budget available. In the current economic climate difficult decisions will have to be made across the public sector about priority spending programmes.

Transport Scotland has been considering the possible role of Best Value toolkits in their processes for reviewing their use of resources. We record the satisfactory outcome of our high level overview of key areas of management, based on our planning tool (Priorities and Risks Framework), which covers many of the areas that would be covered in a Best Value baseline assessment.

Governance and accountability

Corporate Governance is concerned with the structures and process for decision making, accountability, control and behaviour at the upper levels of an organisation. We examined the key financial systems which underpin Transport Scotland's control environment. We concluded that the financial systems and procedures operated sufficiently well to enable us to place reliance on them. We followed up our 2006/07 corporate governance overview and, overall, we concluded that the corporate governance and control arrangements operated satisfactorily during the year, as reflected in the Statement on Internal Control.

Performance

Transport Scotland's Corporate Plan 2008-11 and Business Plan 2009/10 set out four high-level aims, each supported by a set of objectives and targets or milestones. The Annual Report for 2009/10 records outturn against planned key achievements and progress against each of the targets established. Most of the key achievements and targets planned for delivery in 2009/10 were recorded as achieved or partly achieved as appropriate, with some assessed as on-going and one cancelled.

In addition, the Corporate and Business Plans outline Transport Scotland's Working Principles. These are summarised as "Strive for excellence in everything we do" and are encapsulated in five core principles. For 2009/10 all seven targets set were assessed as achieved.

In the sections of the report covering Use of Resources, Governance and Performance we also draw attention to relevant Audit Scotland National Studies, in particular the recently published studies on the National Concessionary Travel scheme and the Role of Boards.

Looking forward

The final part of our report notes some key risk areas for Transport Scotland going forward. In common with all public sector bodies, the potential impact of the tighter funding position going forward on the need for prioritising spending, realising efficiencies and managing budgets. The impact of the merger of Transport Scotland and the Transport Directorate of the Scottish Government on harmonising governance arrangements, financial reporting and other aspects of business processes. Also, Transport Scotland faces a number of other specific challenges to achieve its 2010/11 Business Plan targets for the planning and delivery of transport projects and initiatives, including its efficiency and environmental targets. We will continue to monitor Transport Scotland's performance.

The assistance and co-operation given to us by Agency staff during our audit is gratefully acknowledged.

Audit Scotland

November 2010

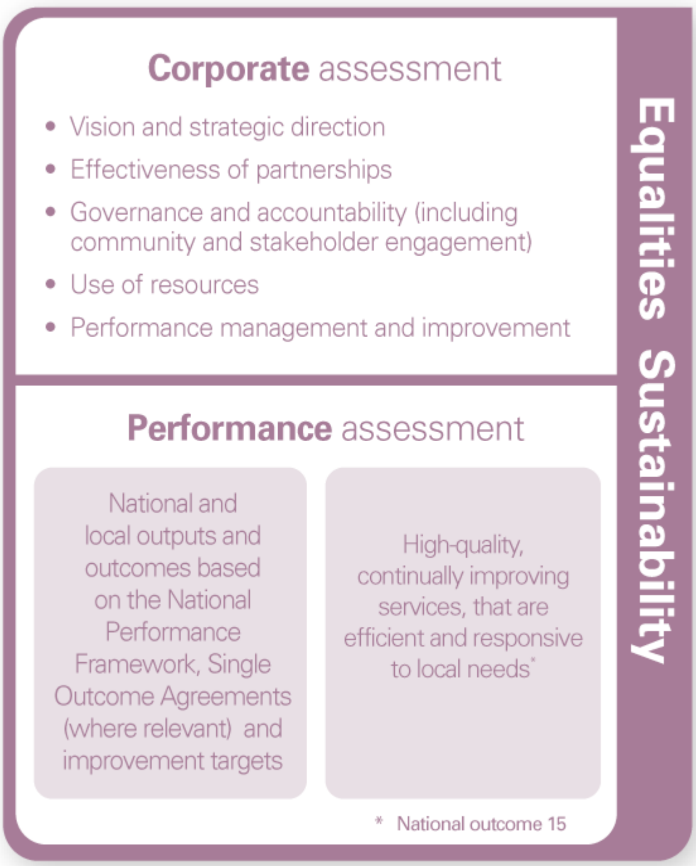
Introduction

1. This report summarises the findings from our 2009/10 audit of Transport Scotland. The scope of the audit was set out in our Audit Plan, which was presented to the Audit Committee on 22 March 2010. This plan set out our views on the key business risks facing the organisation and described the work we planned to carry out on financial statements, performance and governance.

2. We have issued a range of reports and management letters this year, and we briefly touch on the key issues we raised in this report. Each report set out our detailed findings and recommendations and Transport Scotland's agreed response. Appendix A of this report records the desirability of a dry run exercise to assist the preparation of the annual accounts for 2010/11.

3. Best value duties apply across the public sector and are a formal duty on all accountable officers. Audit Scotland has adopted a generic framework for the audit of best value across the public sector and this has been further developed during 2009/10 with the completion of its bank of best value toolkits which, although primarily designed for audit use, are available to all public bodies for reference.

Exhibit 1: Framework for a best value audit of a public body



4. A linked development here has been the Scottish Government's work to refresh its 2006 best value Guidance for Public Bodies. This latter initiative, due for issue later in 2010, will result in clearer guidance to public bodies, and particularly those in the Central Government and Health sectors, on securing continuous improvement in performance, with due regard to the balance between cost and quality.

5. Throughout this report we comment on aspects of Transport Scotland's arrangements in this area. Our comments are made on the basis of information made available in the course of the annual audit. We do not make an overall best value judgement because we do not yet have enough evidence to conclude on all relevant areas. Our intention is to build up the corporate assessment over time. This report represents a further step towards that goal.

6. Another building block for our assessment of best value is the national study programme carried out by Audit Scotland on behalf of both the Auditor General for Scotland and the Accounts Commission. Where these have a bearing on the activities, risks or performance of Transport Scotland, we make reference to these reports in this document. Full copies of the study reports can be obtained from Audit Scotland's website, www.audit-scotland.gov.uk.

7. We would like to take this opportunity to express our appreciation for the assistance and co-operation provided by the management and board members of Transport Scotland during the course of our audit. This report will be submitted to the Auditor General for Scotland and will be published on our website.

Financial Statements

8. In this section we summarise key outcomes from our audit of Transport Scotland's financial statements for 2009/10 and the accounting issues faced. The financial statements are an essential means by which the organisation accounts for its stewardship of the resources available to it and its financial performance in the use of those resources.

Our responsibilities

9. We audit the financial statements and give an opinion on:

- whether they give a true and fair view of the financial position of Transport Scotland and its expenditure and income for the period in question
- whether they were prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements
- whether the information which comprises the Management Commentary and the section Striving Towards Excellence included in the Annual Report is consistent with the financial statements
- the regularity of the expenditure and receipts.

10. We also review the statement on internal control by:

- considering the adequacy of the process put in place by the Chief Executive as Accountable Officer to obtain assurances on systems of internal control
- assessing whether disclosures in the statement are consistent with our knowledge of Transport Scotland.

Overall conclusion

11. We have given an unqualified opinion on the financial statements of Transport Scotland for 2009/10.

12. We were able to conclude most of our audit work within the agreed timetable and report the position to the Audit Committee on 17 July 2010, a month earlier than previously achieved. Following on from that Committee meeting outstanding matters were resolved and the outcomes were confirmed with Audit Committee members in September 2010.

Issues arising from the audit

13. As required by auditing standards we reported to the audit committee the main issues arising from our audit, as indicated above. In line with our normal practice, we will also report separately to

management less significant matters arising from the audit of the financial statements, which do not require to be reported here. The key issues were as follows:

Delays in the accounts preparation and audit process

14. The accounts preparation and audit process ran about 3 to 4 weeks behind timetable. There were two main factors:

 - Most directly, there was a four week delay in achieving reliable output from the Road Asset Valuation System (RAVS). RAVS is not a financial system and the output requires scrutiny and analysis to confirm the reasonableness of the output and to determine the appropriate accounting treatment of the changes in RAVS over the year. Accounting for the road network is a key item that both Transport Scotland and Audit Scotland prioritise, to allow time to resolve any issues arising. Predictably, the delay in receiving RAVS output had a direct knock on to the overall timetable. There was reduced time for Transport Scotland scrutiny and review of the draft account; and planned staff leave, which fitted in with the original timetable, compounded delays in the revised circumstances.
 - The change of accounting rules following the adoption of International Financial Reporting Standards for 2009/10 was a further complicating factor, particularly in relation to roads accounting and PFI. There was good preparatory work on interpretation of the new accounting policies and the restatement of opening balances. However, the final phase of preparatory work, the shadow IFRS accounts for 2008/09, was not completed satisfactorily at the time of the reporting deadline of December 2009. The intention on the part of both Transport Scotland and Audit Scotland had been to carry out further work on this, for example through early preparation of the 2009/10 PFI figures to allow a peer review of the PFI adjustments. In practice there was no significant early work on the 2009/10 accounts, leaving any issues to be picked up as part of the 2009/10 statutory accounts process.

15. By way of balance, we were pleased to note improvements in procedures and documentation in provisions (including those for the compulsory purchase of land) and the review of Operating Companies' road maintenance responsibilities by Performance Audit Group (including the year end accrual).

16. Transport Scotland and Audit Scotland have agreed that it would be helpful to have a "dry run" review of the restated Transport Scotland figures for 2009/10, reflecting the incorporation Transport Directorate; and that this would also afford an opportunity to reflect on any issues arising from the 2009/10 process as still relevant to the 2010/11 accounts and audit arrangements.

Qualitative aspects of accounting practice and financial reporting, including the implementation of International Financial Reporting Standards (IFRS)

17. UK Government departments and other public sector bodies prepared their accounts in accordance with International Financial Reporting Standards (IFRS) for the first time in financial year 2009/10. The transition arrangements to IFRS required bodies to prepare IFRS shadow accounts for 2008/09, including revised opening balances as at 1 April 2008. The implementation of IFRS has involved some significant judgements.

18. On **PFI**, it was not possible to apply the ideal theoretical model for bringing assets on balance sheet, but through exploring options and discussions between Audit Scotland and Transport Scotland a compromise “best fit” model has been applied. The key judgements involved were:

  - there is a hybrid approach to the values at which assets are brought on to the balance sheet: structures at gross book value (to be depreciated at £700k per annum); roads at the net book value they will revert to TS on completion of contract (no depreciation is charged, expenditure on maintaining roads is charged to revenue through the service charge component of the annual unitary payment)
  - the discount/ interest rates adopted are cost of capital plus inflation rather than the “rate implicit in the contract.” The latter is the preferred approach, but given the pattern of annual payments and capital value of assets it was difficult to determine the rate implicit in the contract. The rate adopted is considered a reasonable proxy in guidance issued by HM Treasury for such circumstances.

19. On **asset accounting**, there are some significant changes in accounting treatments. While there are judgements involved in applying the IFRS guidance, it is more the qualitative change in the accounting treatments that we think merit attention:

  - capital maintenance was previously charged direct to maintenance in the OCS under GAAP. Under IFRS it is now capitalised in the road network in the statement of financial position and then expensed through the depreciation charge (2009/10 - £30m).
  - under IFRS, downward movements in valuation are now written off to revaluation reserve in the first instance. For the road surface in particular, this can mean that capital expenditure is written off to revaluation reserve rather than being charged to the OCS by a depreciation or impairment charge as would have been the case under GAAP. This seems an anomaly for Parliamentary accounting, which has traditionally placed great emphasis on comparing outturn expenditure with budget. For 2009/10 the capital expenditure on roads, which is taken to Assets Under Construction, was £255m. Recognition of any write down in value generally takes place on the transfer of assets to the road network. The value transferred out of Assets Under Construction in 2009/10 was £47m, which resulted in an increase in the value of the road network of £14m and a write down in value of £33m charged to the Revaluation Reserve. Previously this write down would have been charged to the OCS under GAAP.

- in the preparatory work on IFRS conversion it was noted that the Highways Agency had interpreted the changes to guidance in this area differently from TS, but that differences were not material.

Way forward on issues arising from the audit of the financial statements

20. In summary, good progress has been made on the transition to IFRS, but there is scope for further development of budgeting and accounting for roads, particularly if the potentially significant changes proposed in Transport Infrastructure Assets Code by CIPFA become applicable for central government accounting. Also, in previous years we have commented on staff continuity and that expertise in certain areas was held by key individuals; and the potential risks to efficient accounting and financial management through a possible loss of “corporate” knowledge/ expertise. The difficulties encountered in 2009/10 underline the complexities of accounting within Transport Scotland. This, taken with the further developments required, such as the merger with Transport Directorate, suggest these aspects of financial reporting will continue to be important going forward. We appreciate that Transport Scotland are aware of these issues and continue to take steps to minimise any associated risks.

Other matters arising

21. In 2008/09 the **Remuneration Report** did not include the financial details relating to the resignation of the former Director of Finance and Corporate Services because he has withheld permission to disclose. Following discussions with officials from Transport Scotland and the Scottish Government and the exchange of documentation we obtained sufficient evidence that the payments on termination of the former Director of Finance and Corporate Services were properly approved and within the scope of relevant rules and regulations. The Auditor General for Scotland (AGS) decided to report to the Scottish Parliament on remuneration arrangements relating to the departures of the former Director of Finance and Corporate Services and the Chief Executive, both of whom left the organisation during the year. The report by the AGS was considered by the Public Audit Committee, which held several evidence-taking sessions and received additional submissions of evidence from the Scottish Government. The outcome of the Committee’s consideration was reported in final form on 20 May 2010 (4th Report, 2009 (Session 3): SP Paper 434). The findings and recommendations relate primarily to the Scottish Government rather than Transport Scotland. The 2008/09 disclosures are included in the 2009/10 Remuneration Report as comparative figures. There are no issues arising in relation to the 2009/10 remuneration disclosures.

Regularity

22. The Public Finance and Accountability (Scotland) Act 2000 imposes a responsibility on auditors that requires us to certify that, in all material respects, the expenditure and receipts shown in the accounts were incurred or applied in accordance with applicable enactments and guidance issued by the Scottish Ministers. We have been able to address the requirements of the regularity assertion through

a range of procedures, including written assurances from the Accountable Officer as to his view on adherence to enactments and guidance; and can confirm that there are no issues to bring to attention.

Use of Resources

23. Sound management and use of resources (people, money and assets) to deliver strategic objectives is a key feature of best value. This section sets out our main findings from a review of Transport Scotland's:

- financial position
- relevant matters arising from the 2009/10 audit
- financial sustainability
- management and use of information and communications technology (ICT).

Financial Position

2009/10 outturn

24. The net outturn for 2009/10 was £2,217 million against a resource budget of £2,261 million, a net under spend of £44 million. For 2008/09 the outturn was £2,055 million against a resource budget of £2,083 million, a net under spend of £28 million; this budget to outturn comparison was based on the accounting rules applicable at that time. The 2008/09 accounts figures have been restated on the basis of IFRS and all other 2008/09 figures in this report are IFRS. Transport Scotland's accounts provide a reconciliation of the restatement of the 2008/09 figures.

Performance against Budget 2009/10 (£million; by Budget category)

Resource Allocation (£million)	Budget	Actual Outturn	Difference
Operating Costs	867	865	(2)
Investment	519	510	(9)
Cost of Capital (notional)	589	533	(56)
Revenue Expenditure	**1,975**	**1,908**	**(67)**
Income	**0**	**0**	**0**
Net Revenue Expenditure	**1,975**	**1,908**	**(67)**
Capital Expenditure	286	309	23
Total Net Outturn	**2,261**	**2,217**	**(44)**

25. Transport Scotland's net operating costs for the year were £1,908 million (2008/09: £1,864 million), including a notional capital charge of £538 million (2008/09: £521 million). Income was £0.2 million (2008/09: £9.3 million). Programme costs accounted for 99% of expenditure. As recorded in the financial statements, expenditure by activity (segmental analysis) is analysed below, with the main components of the change year on year recorded in the programme costs note:

- motorways and trunk roads activities - £882 million (2008/09: £819 million), with the main reason for the increase being capital charges and depreciation, plus an extra £10 million on the Replacement Forth Crossing
- rail services - £639 million (2008/09: £699 million), reflecting a reduction in the ScotRail Franchise payments, due in part to the influence of the regulatory regime
- concessionary travel schemes - £199 million (2008/09: £193 million)
- major rail projects - £188 million (2008/09: £153 million), with increased expenditure on the Edinburgh Trams project, the Airdrie – Bathgate line and the development of depots.

Capital expenditure on the roads assets under construction in the year was £277 million (2008/09: £163 million).

26. As outlined in paragraph 19, the introduction of IFRS has changed the accounting for fixed assets. The factors outlined in paragraph 19 would also need to be taken into account if comparing UK GAAP accounts for 2008/09 with IFRS accounts for 2009/10.

27. At 31 March 2010, Transport Scotland held net assets of £15,643 million, a 5.4% increase from the £14,848 million of the previous year. This largely reflected Scotland's trunk roads network, which, including assets under construction, had a net book value of £16,023 million at the financial year end, an increase of £880 million from the previous year. The most significant factor in the movement is the revaluation of the road network (£700 million). In 2009/10 the revaluation reflected both indexation and a revaluation of the unit costs of certain common road types. In 2008/09 the revaluation was lower and reflected only indexation at £235 million.

Matters arising from the 2009/10 audit

Grant to Edinburgh Trams project

28. Transport Scotland funds a capped contribution to the costs of the Edinburgh trams project, with payments made via City of Edinburgh Council (CEC), the project promoter; the project is managed by tie Ltd a wholly owned subsidiary of CEC. Prior to the commencement of the funded project, the Scottish Government met costs of £17 million on developing and evaluating options for a tram network in Edinburgh and on the Parliamentary process. Two Tramline Bills received royal assent by May 2006. In June 2007, following a Parliamentary debate, an overall budget for the project of £545 million was approved. Transport Scotland is to provide funding up to a maximum of £500 million: CEC must provide their pro-rata share of £45 million.

29. In 2009/10 TS recorded expenditure on the Edinburgh Trams project was £107 million (2008/09: £93 million). Expenditure prior to 2008/09 was £119 million. Cumulative expenditure on the project at 31 March 2010 was £319 million, being Transport Scotland's pro-rata share of the Cost of Work Done of £348 million at 31 March 2010 (see table below). Since the commencement of the project the cash

flows from TS to CEC have involved an element of advance funding, with TS recording a net prepayment element that has varied between £20m to £30m over the period.

30. The funding of the Trams project by Transport Scotland is based on the claims for grant by City of Edinburgh Council. These claims are underpinned by a schedule of the value of work done, which is analysed into components – "the Eligible Capital Costs". On the schedule, the value of work done is compared with the value attributed to the component/ sub component of the contract. Over time the risk/ contingency element of the contract is allocated to the components/ sub components. The total cumulative position on the main components of work done over the past two years is recorded in the table below. The schedule of work done further analyses these total values between the contributions relating to Transport Scotland and the City of Edinburgh Council.

Edinburgh trams project. Value of work done 2008/09 and 2009/10

Date	Total (£m)	Infraco	Tramco	Utilities	Other	Risk
Contract value at 31.03.08	498	224	51	52	122	49
COWD at 31.03.08	130	26	3	18	83	0
% complete at 31.03.08	26%	12%	6%	35%	68%	N/A
Contract value at 31.03.09	527	250	58	52	129	38
COWD at 31.03.09	231	61	15	52	103	0
% complete at 31.03.09	44%	24%	26%	100%	80%	N/A
Contract value at 31.3.10	533	252	58	58	156	9
COWD at 31.03.10	348	117	42	62	127	0
% complete at 31.03.10	65%	46%	72%	107%	81%	N/A

COWD: Cost of Work Done. Infraco: the main infrastructure contract Tramco: the contract for building trams
Utilities: utilities diversion work Other: costs of land, design, project management etc

31. From the valuation statements provided to Transport Scotland, over the 2 years, the main trends are the allocation of risk/ contingency of £40 million and an increase in estimated total contract cost of £35 million. The £75 million increase is spread across main components as follows:

- Infraco +£28m (12%); Tramco +£7m (14%); utilities +£6m (12%), with a further £4m increase to be recovered from utility companies; other +£34m (28%), including project management +£21m (31%).

32. We note that in June 2010 CEC indicated that it was unlikely that they would be able to complete the project as intended within the agreed funding. The Council is examining contingency planning options up to a capital cost of £600 million. Also, the Council is continuing discussions with Transport

Scotland and Scottish Ministers, including on the terms of the current grant. Transport Scotland discloses the position in their accounts as an event after the financial reporting period.

33. The Council meeting in October was provided with an Edinburgh Tram Update Report. The report covered a refresh of the business case, reflecting the likely incremental delivery of the project. It also provided an update on the financial information and progress on the main components of the project; the contractual negotiations; and developments in governance arrangements. The reported Cost of Work Done was £381million (£33 million higher than at 31 March 2010). This reflected Infraco £140 million (+ £23 million); Tramco £46 million (+£4 million); utilities £62 million (no change); and other £134 million (+£6 million).

34. In October 2010 the Auditor General for Scotland and the Accounts Commission asked Audit Scotland to prepare a report on the Edinburgh Trams project for publication around the end of the year. The report will use the findings reported in the annual audit reports of Transport Scotland and the City of Edinburgh Council. It is anticipated that this will be a status report focusing on progress with the project in terms of costs and delivery and will highlight the risks going forward. It will be followed by a further, more detailed, report by Audit Scotland in due course. (We also comment on the governance arrangements for the Edinburgh Trams project at paragraphs 69 and 70 of this report).

Disclosure of expenditure on the Glasgow Airport Rail Link (GARL)

35. There has been significant public and Parliamentary interest in the decision to cancel the GARL scheme and, in particular, the costs associated with the original and revised projects and the costs related to the decision to cancel. As part of the 2009/10 audit, Audit Scotland reviewed the relevant figures and we confirm that the costs are in line with the information provided to Parliament in the answers to the relevant parliamentary questions.

36. In summary, in January 2006 a draft bill was submitted to the Scottish Parliament for the GARL project at an estimated cost of £160 million at 2004 prices (approximately £190 million at 2006 prices). (Development and Parliamentary costs of £3 million were incurred and are excluded from quoted project costs.) In June 2007 it was decided to integrate the GARL work with Network Rail's planned improvements to signalling in the Paisley Corridor. The costs of the integrated project were estimated at approximately £400m at both July 2008 and at the time of cancellation of the project at September 2009.

37. The costs incurred on the integrated project up to the time of cancellation were £48 million, of which £19 million related to GARL, £21 million to the Paisley Corridor and £8 million were joint costs (joint costs are not directly attributable, but for simplicity of the analysis below we split the joint costs £4 million to each GARL and Paisley Corridor). Post-cancellation costs to 31 March 2010 were £20 million of which £4 million related to GARL and £16 million related to the Paisley Corridor. The estimated further closedown costs of GARL are £5 million. The total estimated cost of the GARL project are therefore £32 million, comprising £23 million pre-cancellation and £9 million post

cancellation. GARL expenditure in 2009/10 was £12 million. The projected reduction in planned expenditure for 2009/10 to 2013/14 arising from the cancellation of the GARL project was £175 million.

Financial sustainability

Scotland's public finances

38. The Auditor General's report on *Scotland's public finances, published in November 2009,* contained an overview of the financial environment in Scotland and the pressures and challenges facing the public sector. The aim of this report was to help to inform the debate on the future of public finances in Scotland. The key messages from this report were:

Extract from Auditor General's report *Scotland's public finances*

The public sector is coming under the greatest financial pressure since devolution.

- Scotland's economy is in recession and the public sector is under the greatest financial pressure since devolution ten years ago. It will be very challenging to maintain current levels of public services and meet new demands when resources are tight.
- The Scottish Government and the wider public sector need to work together to develop better activity, cost and performance information. This information is needed to enable informed choices to be made between competing priorities, and to encourage greater efficiency and productivity.

The Scottish Government faces significant challenges in balancing the budget while also delivering on its commitments and meeting increasing demands for public services.

- It remains unclear what impact the current recession will have beyond 2010/11. The Scottish budget is likely to reduce in real terms but the full extent of this is not yet known.
- In many cases, the public sector uses income from various sources to pay for services. Income levels anticipated before the recession are unlikely to be realised, reducing the amount available to spend.
- The Scottish public sector faces significant challenges in balancing its budget while also delivering on its commitments. Changes in Scotland's population and rising unemployment rates will increase demand for public services.
- Two per cent efficiency savings will not be sufficient beyond 2011 to bridge the gap between public spending and the smaller budget available.

In the current economic climate difficult decisions will have to be made about priority spending programmes.

- The Scottish Government's annual budget is largely developed on an incremental basis which involves making adjustments at the margin to existing budgets. This approach is not suitable for budgeting in a financial downturn because it does not easily allow informed choices to be made about priorities, based on robust information about activity, costs and performance.
- The Scottish Parliament has an important role in scrutinising the government's spending plans. Better information linking spending to costs, activities and service performance, and a rolling programme of performance reviews, would support the Scottish Parliament in fulfilling this role.

Financial sustainability and budgets for 2008-2011

39. The Scottish Budget Spending Review 2007 (SR07) set annual spending plans from 2008/09 to 2010/11. The plans are intended to give more focus on long-term outcomes for Scotland and are reviewed annually to cope with changing conditions over the 3 year period. The current annual spending plan for the remaining financial year of SR07 is outlined in the table below. We note that the 2010/11 Summer Budget revision removed the cost of capital provision from all budgets.

Resource allocation (£million)	**2010/11***
Resource – Operating Costs	840
Resource – Investment	498
Non-cash	51
Cost of Capital (notional)	649
Total	**2,038**
Capital	190
Total	**2,228**

*** Source- Budget (Scotland) Bill 2010-11**

40. Transport Scotland is expected to achieve 2% of efficiency savings per year over the three year period of Transport Scotland's corporate plan (2008-11). Delivering efficiencies year on year while absorbing pay inflation and other cost pressures represents a significant challenge for the organisation.

Best Value

41. As part of our 2009/10 audit of Transport Scotland (TS) we have used a Priorities and Risk Framework (PRF) for the first time to inform our risk analysis and update our knowledge of TS

arrangements. PRFs have been used in the audit of the local government and health sectors for a number of years and are now in the process of being developed for use in central government bodies. A brief overview of Best Value (BV) is included in the introduction section of this report. Looking forward, the PRF will be an important part of our approach in targeting audit activity on areas of greatest perceived audit risk.

42. We view the PRF as an internal planning tool, which is used as an agenda for a series of discussions with senior officers. Following completion of our initial assessment, we saw merit in sharing the findings. The PRF assessment suggests that overall TS continues to develop sound arrangements and has reasonable practices in place to secure best value. Our findings are summarised in the following paragraphs.

43. Based on this summary assessment, we identified five areas of potential risk which were reflected in the audit plan (as augmented by specific TS issues):

- **governance & accountability:** a triennial review of the framework document is to be completed following the outcome of the SG review of transport responsibilities
- **financial management and efficiency:** following the next spending review, TS will develop rolling three year revenue and capital budgets in line with the agreed spending profiles; and ensure they maintain their ability to achieve and demonstrate efficiency savings
- **information management:** TS to meet mandatory requirements on information asset management and security
- **risk management:** TS to maintain development/ improve consistency of approach and documentation
- **people management:** TS to monitor use of consultants through development of manpower budgeting and reporting.

44. We note the TS audit committee's recent consideration of best value and BV toolkits and whether an overview baseline corporate assessment of best value would be the most sensible first step. We think that TS would be better to focus on the Financial Management and/ or Efficiency toolkits in the first instance. Our view is that the PRF assessment covers much of the same ground as the overview assessment of BV; and given the generally positive assessment arising from the PRF it would seem more appropriate to examine specific areas in a bit more detail through use of the toolkits. Our expectation is that use of the specific toolkits is more likely to identify areas in which there may be improvements or developments to systems and procedures for TS to consider.

Management and use of ICT

45. As part of our 2009/10 audit we followed up our previous work on the Computer Services Review to determine what progress had made in implementing the agreed actions. We noted that Transport

Scotland had made progress in all areas, for example, the information and communications technology (ICT) strategy has now been formalised following consultation with the ICT Steering Group and approval by the board; and various work streams are being progressed in line with the strategy. Also, arrangements are in hand for further development of areas considered in the original review and follow up, for example, an information asset register is being created and managed by the Knowledge Management Team.

National Studies

46. During the 2009/10 audit we followed up the Transport Scotland's responses to Audit Scotland's *Review of major capital projects* – in particular, the consideration of the Transport Scotland projects that were examined as part of the review. This area will be considered further as part of the national study programme (see paragraphs 50 and 51 below). In addition, we co-operated with colleagues in Audit Scotland who carried out a review of Scotland's National Concessionary Travel scheme, which was introduced in 2006.

National Concessionary Travel scheme

47. The Scheme provides unlimited free bus travel across Scotland for older and disabled people and builds upon earlier concessionary travel schemes operated by councils. The audit examined the development and management of the National Concessionary Travel scheme and its impact and cost. The audit used the findings of reviews undertaken by the Scottish Government and Transport Scotland, which included an evaluation of the benefits of the scheme and a review of the reimbursement rate paid to bus companies for carrying concessionary passengers, as well as reports from internal and external auditors. This was supplemented by further research, information gathering and analysis by the audit team.

48. The report of the review was published in October 2010. The **key messages** were:

- At the outset, there was not a clear statement setting out what NCT was expected to achieve although its general purpose was to provide opportunities and improve the quality of life of concessionary passengers. National guidance states that an options appraisal should be carried out but this was not done. Parliament considered the proposals with only limited cost information available. Financial information covered only partial costs for the first two years of the scheme without any details of the long-term cost implications.
- In line with Scottish Executive plans, NCT was introduced in April 2006. Some basic management systems were in place, but robust systems were not in place to effectively administer and manage the scheme, or to minimise the risk of error and fraud. Transport Scotland has since established systems to check the accuracy of bus company claims, but it has made slower progress in developing performance measures to assess the impact of the scheme.

- New technology, which was a key element of the design of the scheme, could not be introduced in the timescales set. Implementation has taken four and a half years longer than originally planned and cost more than four times the original budget. The technology used had not previously been used operationally and reliance was placed on advice from consultants as Transport Scotland staff did not have the necessary skills.
- The scheme is popular among users with take up at high levels – around 80 per cent of over 60s in Scotland have an NCT pass. However, recent research shows that NCT has had only limited impact on improving social inclusion, improving health or promoting a shift from car use to bus. The Scottish Government's own review said that there is insufficient evidence that NCT is achieving more than the previous local schemes that were in place.
- The cost of NCT (at 2009/10 prices) has increased each year from almost £173 million in 2006/07 to just over £199 million in 2009/10. The costs of the scheme are expected to continue to increase. Based on current levels of concessionary journeys and a range of fare increases, we project the **uncapped** costs of NCT could reach between £216 million and £537 million a year by 2025.
- Since the introduction of NCT, the cost of concessionary bus travel has increased at a faster rate than the number of concessionary bus journeys recorded. The reasons for this are not fully understood by Transport Scotland or the Scottish Government, but are likely to include increases in bus fares, a more generous reimbursement rate paid to bus companies than under the previous schemes and the inclusion of national bus and coach travel.

49. The report records a number of **recommendations**. It makes recommendations to the Scottish Government in relation to the development of all policies and initiatives (not detailed in this report). The report also makes recommendations that are specific to the NCT. The Scottish Government and Transport Scotland should:

- clarify the objectives of NCT and what contribution the scheme is expected to make towards the strategic objectives set out in the National Performance Framework
- consider whether the money it spends on NCT and the impact it has is the best use of public resources at a time of budget restraints
- develop performance measures which allow it to assess the impact of NCT against clear objectives and the strategic objectives set out in the National Performance Framework
- work with councils to understand the reasons for variations in the take up of disabled passes.

Future studies

50. Audit Scotland are about to start fieldwork for the performance audit *'Management of the Scottish Government's capital investment programme'*. As part of this work we will be speaking to Transport Scotland and discussing various aspects of the investment programme.

51. Overall, the project aims to provide independent assurance about how well the Scottish Government is managing its capital investment programme and associated risks. It will also assess and report on the outlook for investment spending and what improvements have been made in major project management since our previous report *Review of major capital projects in Scotland (June 2008).* It is due to be published in January 2011. Transport Scotland contributed information to both the original report and the follow up.

52. *Improving energy efficiency: a follow-up report* will re-evaluate the performance of the public sector in improving its energy efficiency. It will assess progress made against the recommendations in the *Improving energy efficiency report 2008*, and look at changes in public bodies' energy consumption and spending on energy since 2004/05. It will also look at how prepared participating public bodies are for the CRC Energy Efficiency Scheme. It is due to be published in December 2010.

53. Audit Scotland are currently developing a more flexible approach to its national performance audit programme. Our focus continues to be on value for money, economy, efficiency, effectiveness and on governance and accountability. We have developed the following five key themes to help underpin our programme:

- **Managing reductions in public sector budgets:** in recognition of the cost pressures facing public services, and building on and developing issues arising from our reports on Scotland's public finances and Improving public sector efficiency.
- **Investment**: looking at accountability for the use of public funds; examining the scope for reducing cost overruns and improving project management; and assessing whether investing in services with early intervention leads to better outcomes and savings in the longer term.
- **Partnership working:** examining the value for money of partnership working and whether this way of planning and delivering services is making a real difference.
- **User focus and personalisation:** looking across organisational boundaries and identifying cost-effective ways of delivering services which better suit people's needs at the same time as delivering savings.
- **Environmental auditing:** reviewing how Scotland is responding to the challenges of reducing carbon emissions and adapting to climate change.

Governance and Accountability

54. High standards of governance and accountability, with effective structures and processes to govern decision-making and balanced reporting of performance to the public, are fundamental features of best value. This section sets out our findings arising from a review of Transport Scotland arrangements.

55. Increasingly services are being delivered across the public sector through partnership working, sometimes involving complex governance and accountability arrangements. Best value characteristics also include effective partnership working to deliver sustained improvements in outcomes.

Overview of arrangements

56. This year we reviewed:

- key systems of internal control
- progress on developing corporate governance arrangements
- Edinburgh trams project
- internal audit
- arrangements for the prevention and detection of fraud and irregularity, including standards of conduct.

57. Our overall conclusion is that arrangements within Transport Scotland are sound and have operated through 2009/10. Each of these areas will be considered in detail in the following paragraphs.

Systems of internal control

58. Key controls within systems should operate effectively and efficiently to accurately record financial transactions and prevent and detect fraud or error. This supports a robust internal control environment and the effective production of financial statements. In their annual report for 2009/10 the Scottish Government Internal Audit Division, Transport Scotland's internal auditors, recorded their opinion that, based on the internal audit work undertaken during the year; they were able to provide substantial assurance in respect of the Agency's risk management, control and governance arrangements.

59. As part of our audit we reviewed the high level controls in a number of Transport Scotland's systems that impact on the financial statements. Our overall conclusion was that key controls were operating effectively.

60. As a number of the Transport Scotland's financial systems are provided by the Scottish Government, we also relied on the work of the Scottish Government external audit team to assess the effectiveness of key internal controls in the following areas:

- the main accounting system (SEAS)
- accounts payable systems (including the operation of Easebuy)
- the central aspects of the accounts receivable system, and cash and banking systems
- the central aspects of the operation of the fixed asset system
- the central aspects of the operation of the payroll and subsistence systems.

61. The Scottish Government auditors concluded that adequate assurance could be taken from the key controls in all main financial systems with the exception of payroll and travel and subsistence, where only limited assurance could be taken. Limited assurance on travel and subsistence was due to staff shortages in the section dealing with these responsibilities, which led to the same people authorising and inputting claims. As a result the Scottish Government external audit team carried out additional substantive testing and we also undertook additional audit testing on payroll and travel and subsistence to ensure that Transport Scotland's financial statements were not materially mis-stated.

Follow up of Corporate Governance Overview

62. As part of our 2009/10 audit of Transport Scotland, we have undertaken a follow up of the overview of corporate governance carried out in 2006/07 and the developments since then. In the period since the initial review we have monitored developments, commenting on aspects of governance in summary form in interim and/or annual reports on the audit. The findings of this follow up were reported to the TS Audit Committee in July 2010 and a summary of the findings are included in this report for information.

Summary of findings

63. The 2006/07 review, considered the overall framework within which TS operates and commented that since inception TS had made significant progress towards establishing appropriate corporate governance arrangements, while identifying seven areas for further development.

64. The 2009/10 review highlighted that TS have continued to develop and embed their corporate governance arrangements in line with good practice. In particular, in relation to the 2006-07 review, the following areas of significant improvement were noted:

- the development of arrangements supporting the induction, training and development of board members
- a formalisation of guidance and arrangements applicable to non-executive board members

- corporate planning arrangements are sufficiently integrated and embedded within the organisation to allow clear linkages to be developed and objectives monitored
- the desire for continuous improvement is embedded across the organisation with the achievement of TS business improvement actions being monitored and recorded via the corporate business plan objective 'Strive for excellence in everything we do'.

65. In addition, governance arrangements for the areas identified below were also followed up; we noted that arrangements continue to progress and develop and may require further monitoring.

Communication between Transport Scotland and Scottish Government

66. During 2009/10 the responsibility for different aspects of Transport remained split between the Scottish Government and TS; our review confirmed that regular communication channels were maintained over the period. The Transport Shaping Up review, published in April 2010, announced the merger of TS with the Scottish Government Transport Directorate to create a single transport agency to cover all of the Scottish Government's transport responsibilities. The merger took place on 1 August 2010. It is not envisaged that this will involve a change of location for most staff. Clear communication and co-operation remain critical and arrangements should continue to be monitored as responsibilities and/ or other aspects of relationships evolve.

Concessionary Travel

67. Arrangements for the concessionary travel scheme are subject to ongoing scrutiny and improvement by TS, for example, as reflected by the findings of both external and internal audit, with governance arrangements now providing sufficient assurance on the expenditure of the scheme. However, concessionary travel continues to be considered an area of inherent risk and will be monitored as part of the annual audit process. The outcome of the Audit Scotland performance audit is recorded at paragraphs 47 to 49.

Finance re-structure

68. Since our initial review, elements of TS business departments have been restructured, with finance arrangements centralised at the operational level and anticipated benefits and improvements being realised. The Transport Shaping Up review and the on-going need to respond to financial pressures mean that finance roles and responsibilities will be kept under review over the next year. (For example, changes could flow from individuals leaving under Approved Early Retirement (AER) for those age 50 and over and Flexible Early Severance (FES) for those below age 50.)

Edinburgh trams project

69. Paragraphs 28 to 34 of this report outline the respective responsibilities of the parties involved in the Edinburgh Trams project, the arrangements relating to the payment of grant claims and the status of

the project. In terms of the governance arrangements, at the outset of the project, officers from Transport Scotland, City of Edinburgh Council and Transport Initiative Edinburgh (tie) Ltd formed the Edinburgh Trams Project Board. Officers from Transport Scotland maintained a seat on the Board until June 2007, when following a Parliamentary debate, the nature of the Scottish Ministers involvement in the project changed, including the arrangements for funding the project. Scottish Ministers established a cap on their financial contribution of £500 million. Transport Scotland withdrew from the Project Board, reducing their influence over the project to mainly that of providing funding, although mechanisms were introduced to protect minister's interests including the affordability and scope criteria in the conditions of the offer of grant, for example, line 1a to be completed within the financial cap of £545 million. Under this regime Transport Scotland does not consider that it has an oversight role for the project, although regular meetings between the organisations have continued.

70. In relation to other aspects of governance, the Edinburgh Trams project falls within the overall framework that applies across TS, and to other projects, as appropriate to the circumstances and context explained above. For example, there is project appraisal and approval by the Investment Decision Making Board; projects are thereafter monitored on an on-going basis, with grant claims or requests for payment verified and authorised prior to processing; there is regular reporting to the relevant Directorate board and main board as appropriate. Risk management is not a feature of the Tram project governance but would otherwise take place at project/ Directorate and Main board level.

Statement on Internal Control

71. The Statement on Internal Control provided by Transport Scotland's Accountable Officer reflected the main findings from both external and internal audit work. This recorded management's responsibility for maintaining a sound system of internal control and set out Transport Scotland's approach to this. The Statement records developments in the internal control environment, including enhanced arrangements for risk management; planned developments for meeting the requirements set out in the Security Policy Framework for the management and control of risks to information; and an update on the Concessionary Travel Schemes. The Statement also makes reference to the Audit Scotland review of the ScotRail Franchise extension, the consideration of this by the Public Audit Committee of the Scottish Parliament and, in particular, the reinforcing of arrangements for registering and managing potential conflicts of interest (see also paragraph 75 below).

72. We are satisfied that the Statement complies with the relevant guidance in the Scottish Public Finance Manual; that the process put in place by the Accountable Officer to obtain assurances on systems of internal control is adequate; and, that the contents of the Statement are not inconsistent with the information arising from our normal audit work. We are content, therefore, that the Statement on Internal Control discloses Transport Scotland's position appropriately.

Internal Audit

73. The establishment and operation of an effective internal audit function forms a key element of effective governance and stewardship. We therefore seek to rely on the work of internal audit wherever possible and as part of our risk assessment and planning process for the 2009/10 audit we assessed whether we could place reliance on Transport Scotland's internal audit function. We concluded that Scottish Government Internal Audit Division operates in accordance with the Government Internal Audit Manual and therefore placed reliance on their work in number of areas during 2009/10, as we anticipated in our annual audit plan. This included reliance on aspects of internal audit's systems work to avoid duplication of effort.

Arrangements for the prevention and detection of fraud and irregularity, including standards of conduct

74. Transport Scotland has appropriate arrangements in place to prevent and detect fraud, inappropriate conduct and corruption, including policies and codes of conduct for staff and Board members. A separate fraud policy and fraud strategy has been developed for the National Concessionary Travel scheme to provide a framework for dealing with instances of suspected fraud.

75. Transport Scotland used the Scottish Government system for maintaining a register of gifts and hospitality. There are no related party transactions disclosed within the notes to the accounts. Audit work has provided sufficient assurance to validate the content of these disclosures.

Conflicts of interest

76. Following the Auditor General's report on the First ScotRail passenger rail franchise (November 2008) Transport Scotland reviewed and updated its procedures relating to declaration of interests, formally adopting the additional good practice of declarations of interest being a standing agenda item for meetings of the Board, the Investment Decision Making Board and the Audit Committee. Our review confirmed that the records reflect the operation of this arrangement.

National Studies

77. In late September 2010, Audit Scotland published a national study on *The Role of Boards* which is relevant to the governance of Transport Scotland. The audit assessed the arrangements in place for the different types of body; how Board members are selected and whether the membership of Boards is appropriate; and reviewed how the performance of Boards is measured and the arrangements for induction and training for non-executive members.

78. The study made recommendations relating to the Scottish Government's responsibility for the overall landscape of public sector boards; and recommendations relevant to bodies themselves. Transport Scotland was not part of the study, but other Executive Agencies were included. The study report

explained the difference between Executive Agency boards, which are advisory and those of NDPBs and NHS bodies, which are directly accountable to the Scottish Ministers and the Scottish Parliament.

79. Non-executive board members of Agencies should have a governance oversight role, with a non-executive chairing the audit committee and they have an advisory role in supporting the Chief Executive in his or her role as Accountable Officer. From our work on corporate governance at Transport Scotland in previous years we confirmed that these roles were understood and were being carried out. We also confirmed that Transport Scotland had taken appropriate steps to develop the relevant induction and training arrangements.

80. *The Role of Boards* study also made the following high level recommendations which were applicable to all public bodies:

- to ensure that their boards focus their scrutiny on organisational performance, financial management and risk management; and
- to review the use of committees and ensure that major decisions which should be made by the board are not delegated.

Our governance work to date has not identified any particular issues in relation to these areas, but the study may provide an opportunity for the board to review its role and operations in light of the good practice and recommendations identified in the report.

Performance

81. Public audit is more wide-ranging than in the private sector and covers the examination of, and reporting on, performance and value for money issues. Key features of best value include:

- setting a clear vision of what the organisation wants to achieve, backed up by plans and strategies to secure improvement, with resources aligned to support their delivery
- a performance management culture which is embedded throughout the organisation and a performance management framework which is comprehensive and supports the delivery of improved outcomes.

82. In this section we comment on:

- Transport Scotland's corporate and business plans
- performance against targets
- arrangements for performance management and risk management
- Transport Scotland's efficiency programme
- relevant national studies, including improving efficiency and maintaining Scotland's roads.

Vision and strategic direction

83. Transport Scotland published its Corporate Plan for 2008 – 2011 in September 2008. The 2009/10 Business Plan was published in June 2009. These plans are structured around Transport Scotland's Delivery Priorities and its Working Principles. The Delivery Priorities are firmly focused on the Government's Purpose (increasing sustainable economic growth), its Strategic Objectives (to make Scotland wealthier and fairer; smarter; healthier; safer and stronger; and greener) and many of its National Outcomes. Transport Scotland's Delivery Priorities are:

- improved connections across Scotland
- better journey times, better reliability
- greener transport alternatives, reduced emissions
- increased safety, more innovation.

84. In addition, the Corporate Plan outlines Transport Scotland's Working Principles. These are summarised as "strive for excellence in everything we do", but are encapsulated in five core principles:

- strive to become a centre of excellence in transport delivery, both nationally and internationally
- promote transport integration

- maintain a clear outward focus on the needs of transport users
- work in partnership with other transport providers and wider government in our planning and delivery
- make the most efficient use of public resources, and equip our staff to do the best possible job.

85. Within each Delivery Priority, and for the Working Principles, Transport Scotland has set proposed key deliveries or actions along with timescales. Transport Scotland identifies tasks and targets within its annual Business Plan that contribute to achievement of the Corporate Plan Priorities; and keeps these tasks and targets under review to monitor their achievements.

Performance overview

86. Transport Scotland's Annual Report for 2009/10 records the delivery of 9 key achievements as per the table below.

Transport Scotland Business Plan Outturn Report on Key Achievements for 2009/10

Target	Delivery
A contract to design and build the Replacement Forth Crossing	November 2009
Significant progress in the completion of the M74	Ongoing
Improved collaboration with Scottish Government colleagues to streamline the planning system	Ongoing
The commencement of work on the A96 Fochabers and Mosstodloch Bypass	October 2009
The commencement of work on the new railway to the Borders	March 2010
A new hourly fast service between Edinburgh and Glasgow via Shotts	December 2009
Continued excellence in sustainable construction and maintenance	Ongoing
Safety enhancements to the A9 and A77	March 2010
Enhancements to our partnership working and internal business processes as we strive for excellence in all that we do	Ongoing

87. A more detailed record of progress against each Business Priority, in terms of its component targets, is also provided in the annual report and accounts. A brief summary and commentary on the achievement of targets by Business Priority is provided below.

Summary progress against 2009/10 targets by Business Priority

Business Priority	Commentary on achievement of targets
Improved connections across Scotland	7 targets were rated as achieved, with 2 partly achieved, 3 on-going and 1 cancelled (GARL).
Better journey times, better reliability	6 targets were rated as achieved, with 2 partially achieved and 2 ongoing.
Greener transport alternatives, reduced emissions	7 targets were rated as achieved and 1 on-going.
Increased safety, more innovation.	3 targets were rated as achieved and 2 as partly achieved.
Strive for excellence in everything we do	All 7 targets were rated as achieved.

88. Most of the targets which were planned to be achieved in 2009/10 were achieved, with some recorded as partly achieved, some as ongoing and one cancelled (Glasgow Airport Rail Link). The target to establish and run the Scottish Bus Service Operator Grant scheme from 1 April 2009 was deferred; responsibility transferred to Transport Scotland following the merger with Transport Directorate.

Performance management

89. The Transport Scotland Board regularly reviews performance against the business plan through the monthly board pack, discussing progress and taking appropriate action to resolve any issues arising.

90. The delivery of the corporate plan objectives will be challenging given the tight financial constraints over the same period. This is an area we will keep under review during our appointment.

91. During 2009/10 Internal Audit reviewed internal and external performance reporting producing a series of recommendations in relation to the development and use of Key Performance Indicators to supplement Transport Scotland's existing internal and external reporting, including the outcome based reporting that has been adopted. Transport Scotland has accepted the recommendations of this report and will implement them over the course of the next year.

Risk management

92. Transport Scotland staff have been managing major projects and operating in a culture of risk management for many years. Since its inception Transport Scotland has built on the risk management arrangements inherited from the Scottish Government embedding these into the activities and functions at both a Directorate and corporate level. Practice at Directorate level will vary according to circumstance, but, for example, significant projects will have their own risk register. Directorates will consider their risk registers at monthly Directorate board meetings and sometimes

more frequently at less formal meetings of management; and the Corporate Risk Register has been part of the monthly Board pack and formally considered at each Board meeting. Also, the Audit Committee has a role in overseeing risk management arrangements.

93. During 2008/09, to further strengthen arrangements, Transport Scotland formalised a high-level Risk Strategy setting out a consistent approach to the implementation of risk management within Transport Scotland at strategic, programme and project levels; and established a Risk Management Committee, which is responsible for developing a Risk Framework, for maintaining the Corporate Risk Register and for facilitating the production and management of risk registers within project teams and Directorates on an appropriate and consistent basis. The Risk Committee consists of the functional directors accompanied by at least one risk champion from their Directorate. The Risk Committee will report formally to the Board on a quarterly basis.

94. During 2009/10 we reviewed and confirmed the operation of these new arrangements: that the departmental risk registers feed into the corporate risk register which the board reviews; practices exist to ensure a consistent format for the risk registers is used across departments; and the risk registers are linked to TS business plans. In terms of documentation, further development is on-going to improve the consistency, presentation and level of detail included in the various risk registers.

Improving public sector efficiency

95. The Audit Scotland report *Improving public sector efficiency* was published on 25 February 2010. It provided a position statement on the first year (2008/09) of the Efficient Government Programme (the Programme), which aims to deliver £1.6 billion efficiency savings over the three years to 2010/11. It also gave an update on how the Scottish Government and public bodies have addressed the recommendations made in the 2006 report about the previous efficiency programme.

96. The report found that Scottish public bodies reported more efficiency savings than the Government's two per cent target. But there are serious financial challenges ahead – the biggest since devolution – and making the required savings through efficiency will become increasingly difficult.

97. The report recommended that to deal with reduced future funding and increase savings public bodies need to consider fresh approaches to improving efficiency and productivity. They must take a more fundamental approach to identifying priorities, improving the productivity of public services, and improving collaboration and joint working.

98. The drive to improve efficiency and productivity is not just an exercise for managers and service providers. It requires strong leadership and engagement from the very top of public bodies. Leaders and senior decision-makers within an organisation have a responsibility to check, challenge, monitor and support their organisations in delivering efficiency and productivity improvements. The report's recommendations highlighted areas that public bodies' key decision makers should look at to assess their organisation's development and to challenge existing arrangements (see below).

Extract from Audit Scotland report *Improving public sector efficiency*

In order to improve the delivery of efficiency savings public bodies should:

- ensure they have a priority-based approach to budgeting and spending
- continue to improve collaboration and joint working, overcoming traditional service boundaries
- consider using alternative providers of services, if these providers can improve the efficiency, productivity or quality of services
- improve information on costs, activity, productivity and outcomes, including setting baselines to measure performance against
- give greater urgency to developing benchmarking programmes
- maintain the momentum of activities and initiatives to improve purchasing and asset management and extend shared services
- ensure there is a joined-up approach to efficiency savings across the public sector, avoiding duplication
- ensure that plans are in place to deliver savings, clearly setting out what action will be taken, the level of savings to be delivered and how these will be measured
- strengthen the involvement of front-line staff, service providers and users in redesigning public services
- reduce reliance on non-recurring savings to meet financial targets and generally use these as part of a wider and longer term strategy
- report efficiency savings consistently.

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99. To support these high-level recommendations, Audit Scotland, the Northern Ireland Audit Office and the Wales Audit Office have drawn on their combined experience to develop a detailed good practice checklist. The checklist is intended to promote detailed review and reflection and, if necessary, a basis for improvement. We recommend that those responsible for leading efficiency and improvement work should consider assessing themselves against each question, and recording the results.

Efficiency

100. Transport Scotland has been expected to achieve 2% of efficiency savings per year. This translated into a target of £58 million for 2009/10, with Transport Scotland recording in their Annual Report achieved efficiencies of over £60 million through more competitive prices for trunk road management and maintenance; negotiating savings on the Airdrie-Bathgate rail project; and by obtaining a more efficient level of grant funding to Network Rail. Over the three year period of Transport Scotland's

corporate plan (2008-11), Scottish Ministers have set a target of delivering efficiency savings in excess of £150 million. In Transport Scotland's business plan for 2010/11 the Agency's target is to achieve savings of at least £70 million.

101. We will continue to monitor the financial position and the actions taken by Transport Scotland to manage these risks. During 2008/09 and 2009/10, Transport Scotland has achieved efficiency savings in excess of target. In the current economic climate, achieving efficiency savings in excess of £70 million will require a series of measures to be implemented. The effects of the spending review have yet to be published, although this will likely propose further reductions in budgeted expenditure in the region of 15 percent in future years.

National Studies

102. The Accounts Commission and Auditor General have published a number of national reports in recent years relating to public sector asset management. One of the earliest was *Maintaining Scotland's roads,* published in November 2004. This examination concluded that the trunk road operating companies had completed three years of contracting with good performance; therefore there were no major recommendations for trunk road maintenance. However, there was significant scope for improving councils' arrangements for road maintenance. A follow-up review is underway which proposes to examine councils' progress in implementing the recommendations in *Maintaining Scotland's roads* and whether the condition of council maintained roads has improved. It will also look at the more recent performance of the operating companies contracted by Transport Scotland to maintain the trunk roads. Earlier audit reports have shown that cutting maintenance expenditure may appear to be an attractive means of making short term savings but provides poor long-term value for money. The severe weather during the 2009/10 winter and its impact on road surfaces and road budgets also make this follow-up performance audit both desirable and timely. It is anticipated the report will be published in February 2011.

Looking Forward

103. Transport Scotland faces a number of challenges in 2010/11, which include:

- **Efficiencies and future funding** - Scottish public bodies have reported more efficiency savings than the Government's two per cent target, but the announcement of future budget cuts by the new UK government indicates that there will be serious financial challenges ahead – the biggest since devolution – and making the required savings through efficiency will become increasingly difficult. To deal with reduced future funding and increase savings fresh approaches to improving efficiency and productivity must be considered, taking a more fundamental approach to identifying priorities, improving the productivity of public services, and improving collaboration and joint working. This creates challenges for Transport Scotland, working with colleagues in Scottish Government, in terms of managing budgets within year, prioritising spending, identifying efficiencies and reviewing future commitments to ensure delivery of key targets and objectives.

- **Merger of Transport Scotland and Transport Directorate of Scottish Government** - The merger of Transport Scotland and the Transport Directorate of the Scottish Government will require a harmonising of governance arrangements, financial reporting and other aspects of business processes; and the framework document will need to be updated to reflect the new merged organisation.

- **Developments in accounting for roads –** Good progress has been made on the transition to IFRS, but there is scope for further development of budgeting and accounting for roads, particularly if the potentially significant changes proposed in Transport Infrastructure Assets Code by CIPFA become applicable for central government accounting.

- **Best Value** - The concept of best value is seen as a key driver of modernisation and improvement in public services. Audit Scotland has continued its commitment to extending the best value audit regime across the whole public sector and significant development work has taken place over the last year including the finalisation of its best value toolkits. This has been matched by the Scottish Government's commitment to refreshing its Best Value Guidance for Public Bodies. Transport Scotland should continue to respond to this important initiative as it develops.

- **Trams** – We will continue to monitor developments on the Edinburgh Trams project and liaise with Transport Scotland and colleagues in Audit Scotland.

Appendix A: Action Plan

Key Issues/ Risk Areas and Planned Management Action

Action Point	Issue/ risk Identified	Planned Action	Responsible Officer	Target Date
1	**Dry run accounts/ audit** Transport Scotland need to restate its accounts figures for 2009/10 to reflect the incorporation Transport Directorate within Transport Scotland for 2010/11. Having discussed the position with Transport Scotland we agree that it would be helpful to have a "dry run" review of the restated figures before the final accounts process. Such an exercise would also provide a focal point to reflect on any issues arising from the 2009/10 process that will still be relevant to the 2010/11; and also to take stock of the developments in accounting for roads.	We confirm that we are preparing for the integration of the financial reporting of Transport Directorate with Transport Scotland, including the restatement of 2009/10 figures, which we have agreed will be available for audit in January 2011.	Financial Controller	January 2011