

The Scottish Road Works Commissioner

Annual Report on the 2010/11 audit



Prepared for the Scottish Road Works Commissioner and the Auditor General for Scotland
November 2011

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. It provides services to the Auditor General for Scotland and the Accounts Commission. Together they ensure that the Scottish Government and public sector bodies in Scotland are held to account for the proper, efficient and effective use of public funds

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Key messages

2010/11

Our independent auditor's report provided an unqualified opinion on the financial statements of The Scottish Road Works Commissioner (the Commissioner or SRWC) for 2010/11. 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 the Scottish Ministers.

In 2010/11 SRWC's financial outturn was approximately 5% higher than that reported for the previous year. Activity on the Roadwork Register is funded by fees levied on the road works community (expenditure of £879 thousand), with expenditure on the Office of the Commissioner being funded by grant from the Scottish Government (expenditure of £259 thousand). Expenditure was within the budgets established for both types of activity.

As reflected in the Statement on Internal Control, SRWC continued to develop its corporate governance and control arrangements and we confirmed these operated satisfactorily during the year. Also, as recorded in the annual report, SRWC substantially met its performance targets. Of 27 targets set, SRWC assessed 22 were met, 3 were partially met, 1 was not met and 1 was no longer applicable to the actual circumstances in 2010/11.

Outlook

The contract for maintaining and developing the Scottish Road Works Register was re-tendered in the run up to the letting of the new contract in April 2011. The costs of re-tendering and implementing the new contract were significant in relation to the annual charge of the contract. We support the Commissioner's decision to review the outcome of this exercise and consider the implications:

- On the income side, it is likely that the cyclical increase in expenditure incurred in re-letting the contract in the future will be met by charging the road works community more on an annual basis than is required to meet the costs for the year concerned; and deferring a portion of the fee invoiced to match the costs of re-tendering and implementing the next new contract.
- On the expenditure side, a review of the contract letting exercise would provide a starting point for assessing the potential for reductions in these costs (methods and costs of re-letting; VAT considerations, etc). It is important to consider the contract costs, as the scope for reduction in other costs would appear to be marginal.

We note the Commissioner's plans to further develop their corporate governance and performance arrangements; and also the anticipated involvement in the Scottish Roads Maintenance Review, which was announced in March 2011, following consideration of the Audit Scotland performance report on this topic. We will follow up on these developments as part of our 2011/12 audit.

Introduction

1. This report is the summary of our findings arising from the 2010/11 audit of The Scottish Road Works Commissioner (the Commissioner or SRWC). The purpose of the annual audit report is to set out concisely the scope, nature and extent of the audit, and to summarise the auditor's opinions (i.e. on the financial statements) and conclusions and any significant issues arising. The report is divided into sections which reflect the extent of our public sector audit model.
2. This report is addressed to the Scottish Road Works Commissioner and the Auditor General for Scotland. This report should be made available to stakeholders and the public after the formal completion of the audit of the financial statements and, where appropriate, form a part of discussions with those involved in governance. Audit is an essential element of accountability and the process of public reporting. This report will be published on our website after consideration by the Commissioner.
3. The management of the audited body is responsible for preparing financial statements that show a true and fair view and for implementing appropriate internal control systems. Weaknesses or risks identified by auditors are only those which have come to our attention during our normal audit work, and may not be all that exist. Communication by auditors of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management of its responsibility to address the issues raised and to maintain an adequate system of control.

Financial statements

4. Audited bodies' financial statements are an essential part of accounting for their stewardship of the resources made available to them and their performance in the use of those resources.
5. Auditors are required to audit financial statements in accordance with the timescales set by Audit Scotland, which may be shorter than statutory requirements, and give an opinion on:
 - whether they give a true and fair view of the financial position of audited bodies and their expenditure and income
 - whether they have been properly prepared in accordance with relevant legislation, the applicable accounting framework and other reporting requirements
 - the regularity of the expenditure and income (except for local government bodies).
6. Auditors review and report on, as appropriate, other information published with the financial statements, including the management commentary, statement on internal control and the remuneration report. Where required, auditors also review and report on the Whole of Government Accounts return. This section summarises the results of our audit on the financial statements.

Audit opinion

7. We have given an unqualified opinion that the financial statements of SRWC for 2010/11 give a true and fair view of the state of affairs of SRWC and of its net operating cost for the year. SRWC is required to follow the 2010/11 Government Financial Reporting Manual (the FReM) and we confirm that the financial statements have been properly prepared in accordance with the FReM.

Regularity

8. In accordance with the requirements of the Public Finance and Accountability (Scotland) Act 2000, we have also provided an opinion that, in all material respects, the expenditure and receipts in the financial statements were incurred or applied in accordance with applicable enactments and guidance.

Remuneration report and statement on internal control

9. In our opinion, the audited part of the remuneration report has been properly prepared and the remaining elements of the remuneration report and management commentary are consistent with the financial statements.
10. We also confirm that we have no issues to report to you on the statement of internal control and its compliance with guidance.

Accounting issues

Accounts preparation and audit

11. In previous years we have commented on year end accounts preparation and audit processes, which are relatively complicated given the size and nature of the Commissioner's activity. There has been good progress over the years to make these arrangements work effectively, but they remain vulnerable to changes in the personnel involved from the various parties that have a role in the process. We recommend therefore that this is kept under review in 2011/12; with the SRWC documenting the key steps in the process and, if assessed as appropriate, the external accountants performing a pre-year end check to ensure that the ledger is up-to-date and that all arrangements are in-hand to facilitate preparation of the 2011/12 statutory accounts.

Presentational and monetary adjustments to the unaudited accounts

12. A number of presentational changes were required to the annual report and accounts as a result of our review of the disclosures required by the FReM and the audited financial statements have been adjusted to reflect this. All central government bodies have been affected by the removal of the cost of capital in the 2010/11 FReM. This change had no effect on the Commissioner's financial statements as the notional cost of capital has been £nil in previous years.

Income recognition policies

13. The main issue arising relates to reaching an agreement to put on a more formal footing an accounting treatment for future years. The contract for maintaining and developing the Scottish Road Works Register was re-tendered in the run up to the letting of the new contract in April 2011. The budget for re-tendering and implementing the new contract was significant in relation to the annual charge of the contract. This significant budget related to the anticipated up-front development costs for enhanced provision of the register. The implications of this cyclical increase in expenditure have been considered and, going forward, the approach will continue to be to charge the road works community more on an annual basis than is required to meet the costs for the year concerned. A portion of the fee invoiced in any one year will be deferred, with the deferred income released in the year in which the contract is let again to match the costs of retendering and implementing the new contract.

Outlook

14. As indicated above, SRWC will update its policy on income recognition and deferral for 2011/12. In addition, the main change in the financial reporting framework (FReM) next year (2011/12) is that grants and donated assets should be recognised immediately, unless there is a condition that the recipient had not satisfied that would lead to repayment. This change is unlikely to have much (if any) impact on SRWC.

15. Looking further ahead, from 1 January 2013 changes to international financial reporting standards (IFRSs) will become effective. This includes the introduction of:
- IFRS 9 - financial instruments (replacing IAS39)
 - IFRS 10 - consolidated financial statements (replacing IAS27)
 - IFRS11 - joint arrangements (replacing IAS31)
 - IFRS12 - disclosure of interest in other entities (replacing IFRS12)
 - IFRS 13 - fair value.
16. Revisions to the FReM for 2013/14 are included in the Financial Reporting Advisory Board (FRAB) forward work programme for 1 December 2011.

Audit appointment for 2011/12

17. Audit appointments are made by the Auditor General, either to Audit Scotland staff or to private firms of accountants for a five year term. 2010/11 is the last year of the current audit appointment cycle and the procurement process for the next five years was completed in May 2011. Audit Scotland will continue to provide the annual audit, but as part of the consequential changes from the procurement exercise there will be a managed changeover to a new audit team. We look forward to continuing the good working relationship that exists and thank the Commissioner and his staff for their assistance during the last 4years.

Financial position

18. Audited bodies are responsible for conducting their affairs and for putting in place proper arrangements to ensure that their financial position is soundly based.
19. Auditors consider whether audited bodies have established adequate arrangements and examine:
 - financial performance in the period under audit
 - compliance with any statutory financial requirements and financial targets
 - ability to meet known or contingent, statutory and other financial obligations
 - responses to developments which may have an impact on the financial position
 - financial plans for future periods.
20. These are key areas in the current economic circumstances. This section summarises the financial position and outlook for the organisation.

Financial results 2010/11

21. The Consolidated Operating Cost Statement for SRWC records expenditure of £1,138 thousand (2009/10: £1,084 thousand) and income of £879 thousand (2009/10: £818 thousand), resulting in net expenditure before tax of £259 thousand (2009/10: £266 thousand), primarily funded by grant from the Scottish Government of £265 thousand (2009/10: £262 thousand).
22. In 2010/11 the Commissioner's operating costs were £23 thousand within the budget established by the Scottish Government for the costs of the Commissioner and his office; the costs of operating the Scottish Road Works Register (SRWR or Register) were £56 thousand within the budget established for activity on the Register.

Cost pressures

23. As part of our 2009/10 annual report on the audit we recorded the financial pressures facing the public sector in Scotland. We recognise that many of the decisions already taken by the Commissioner will minimise costs: in particular, the decisions to locate within a Scottish Government office and make use of Scottish Government systems and services. However, going forward, against a backdrop of expenditure constraint, the Commissioner may need to look again at opportunities for savings. It may be possible to achieve some savings through a further review of individual items of SRWC & Susiephone costs, but this would seem to be at the margins. Also, given the small number of staff involved, the Commissioner will not be in a position to seek the target 10-15% reductions in staff that has been adopted at some other bodies. The Commissioner has expressed the view that his office is now seen as a resource by the road works community as a source of expertise. Scottish Government has increased

its use of this expertise as recent staffing reductions have reduced their own in-house expertise.

24. There are 2 areas of the activity of the Scottish Roads Works Register that could be explored further:
- **the main contract for provision of SRWR** – The retendering exercise was completed recently. The budget for re-tendering and implementing the new contract was significant in relation to the annual charge of the contract. Although it will be some years before a further retendering exercise will be required, it would be an appropriate time for a post completion review of the recent exercise. Given the relatively high expense, it would seem appropriate to seek guidance from the Scottish Government (or Transport Scotland) procurement advisors as part of the review to examine whether there may be a more cost effective approach, for example, whether a single tender type process with some form of expert input to confirm VfM may be appropriate.
 - **irrecoverable VAT** – There is now clarity that the Commissioner will not be eligible to recover VAT under the “contracted out” rules that are available to Government Departments. Any further progress on reducing their recoverable VAT costs to the Scottish road works community would therefore be dependent on restructuring the basic arrangement. This is a complex situation and any change would most likely require consideration at a strategic level, with any actions being over the medium term. The review would need to consider, among other things:
 - the need for, and role of, a company (Susiephone Ltd) in the arrangement
 - the possibility of minimising irrecoverable VAT, for example, may it be possible for Scottish Ministers to contract with Symology and recover VAT under contracted out rules
 - the legal status of Commissioner, being an individual, rather than a corporate entity - and whether it is appropriate for an individual to enter into major contracts (this was considered in our governance review of 2009/10).

Action plan point 1

Financial position at 31 March 2011

25. The Statement of Financial Position shows a consolidated net asset position of £76 thousand at 31 March 2011 (£70 thousand for 2009/10); the Commissioner only position is net assets of £9 thousand (£3 thousand for 2009/10). SRWC has a relatively low capital budget reflecting the nature of the organisation and its business. The reported outturn for 2010/11 was £2 thousand consolidated and £1 thousand Commissioner (2009/10: £1 thousand and £nil, respectively).

Outlook

26. SRWC has a total approved budget for expenditure of £280 thousand for 2011-12 for Commissioner activity and £1,059 thousand for SRWR activity, including £108 thousand

planned deferred income. In addition, in 2011-12, the accounts will reflect the sums for re-tendering and implementing the new contract for the SRWR referred to above of £220 thousand, which have been included in previous years' budgets.

Governance and accountability

27. The three fundamental principles of corporate governance – openness, integrity and accountability – apply to all audited bodies, whether their members are elected or appointed, or whether they comprise groups of people or an individual accountable officer.
28. Through its chief executive or accountable officer, each body is responsible for establishing arrangements for ensuring the proper conduct of its affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Audited bodies usually involve those charged with governance (including audit committees or similar groups) in monitoring these arrangements.
29. Consistent with the wider scope of public audit, auditors have a responsibility to review and report on audited bodies' corporate governance arrangements as they relate to:
 - corporate governance and systems of internal control
 - the prevention and detection of fraud and irregularity
 - standards of conduct and arrangements for the prevention and detection of corruption
30. In this part of the report we comment on key areas of governance.

Corporate governance

Overview

31. We carried out an overview of the Commissioner's governance arrangements in 2009/10, concluding that SRWC was a small and recently formed organisation which had made progress in developing and implementing corporate governance arrangements. We noted:
 - the role of Commissioner built on the previous arrangements for the operation of the Scottish Roads Works Register, including the role of Susiephone Ltd and the contract with Symology Ltd
 - key stakeholder involvement was maintained through the board of Susiephone Ltd
 - lines of authority and accountability and arrangements for contracting and accounting were relatively complex
 - there was a "sponsor" role within Scottish Government to provide independent advice guidance and scrutiny, but there may also be merit in establishing an audit committee or advisory board to help in this area
 - there may be merit in making provision for an internal audit function to provide management with assistance in evaluating and improving the internal control environment.

32. In 2010/11, we followed up governance developments. As confirmed in the Statement on Internal Control, the Commissioner has continued to develop arrangements, including agreeing with Scottish Government an appropriate basis for their provision of internal audit coverage.

Internal control

33. In the interests of an efficient audit approach we rely on assurances received from the auditor of the Scottish Government on work performed on shared systems that operate at SRWC, hosted by the Scottish Government. This approach ensures we are delivering an efficient co-ordinated audit that avoids unnecessary duplication and expense.
34. The central systems assurance letter provided by the auditor of the Scottish Government concluded that there was adequate assurance for all systems except travel and subsistence payments. Adequate assurance is where key controls and procedures are operating to enable reliance to be placed on the system; limited assurance was provided for the travel and subsistence (T&S) system due to controls concerns. However, we found SRWC procedures to be operating satisfactorily.
35. The Statement on Internal Control (SIC) provided by SRWC's Accountable Officer records management's responsibility for maintaining a sound system of internal control and summarises the process by which the Accountable Officer obtains assurances on the contents of the SIC. It also records the further development of arrangements.
36. Our audit approach includes a review of the high level controls operating within SRWC's key financial systems. Although there are small numbers of staff, which limits the scope for segregation of duties, there is compensating control through a high level of scrutiny by the Commissioner and through independent advice and review of the activity of the Register. Our overall conclusion from the 2010/11 review was that key controls were operating effectively and that SRWC has adequate systems of internal control in place.

Prevention and detection of fraud and irregularities

37. Audited bodies are responsible for establishing arrangements to prevent and detect fraud and other irregularity. Auditors review and report on these arrangements.
38. SRWC has appropriate arrangements in place (based on Scottish Government guidance) to prevent and detect instances of fraud and corruption including detailed policies which have recently been reviewed and updated.
39. There were no instances of fraud or corruption reported by SRWC in 2010/11.

Standards of conduct and arrangements for the prevention/detection of bribery and corruption

40. Audited bodies are responsible for ensuring that their affairs are managed in accordance with proper standards of conduct and have proper arrangements in place for implementing and

monitoring compliance with standards and codes of conduct, standing orders and financial instructions. We have concluded that the arrangements in SRWC are satisfactory and we are not aware of any specific issues that we need to identify in this report.

Outlook

41. We note the progress that SRWC has made in developing its corporate governance arrangements and the Commissioner's plans to further develop these arrangements, in particular, in relation to risk management and business continuity planning. It is likely that the incoming auditors will follow up developments in governance arrangements as part of the 2011/12 audit.

Best Value, use of resources and performance

42. Accountable officers have a specific responsibility to ensure that arrangements have been made to secure Best Value.
43. The Auditor General may require that auditors consider whether accountable officers have put in place appropriate arrangements to satisfy their corresponding duty of Best Value. Where no requirements are specified for auditors in a period they may, in conjunction with their audited bodies, agree to undertake local work in this area.
44. As part of their statutory responsibilities, the Auditor General and Accounts Commission may procure, through Audit Scotland, examinations of the use of resources by audited bodies and publish reports or guidance. Auditors may be requested from time to time to participate in:
 - a performance audit which may result in the publication of a national report
 - an examination of the implications of a particular topic or performance audit for an audited body at local level
 - a review of a body's response to national recommendations.
45. Auditors may also consider the use of resources in services or functions, where the need for this is identified through local audit risk assessments. Audit Scotland has prepared a series of Best Value toolkits to facilitate its reviews in these areas.
46. During the course of their audit appointment auditors should also consider and report on progress made by audited bodies in implementing the recommendations arising from reviews in earlier years.
47. This section includes commentary on Best Value/performance management arrangements within SRWC. We also comment on any headline performance outcomes/measures used by SRWC and comment on any relevant national reports and the body's response to these.

Management arrangements

Best Value

48. In March 2011, the Scottish Government issued new guidance for accountable officers on Best Value in Public Services. The new guidance, in essence, required public bodies to take systematic approach to self-evaluation and continuous improvement.
49. The guidance identifies the themes which an organisation needs to focus on in order to deliver the duty of Best Value, but notes that implementation should be appropriate and proportionate to the priorities, operating environment, scale and nature of the body's business.

50. The five themes and two cross-cutting themes (some of which we have commented on earlier in this report) are:
- vision and leadership
 - effective partnership
 - governance and accountability
 - use of resources
 - performance management
 - equality (cross-cutting)
 - sustainability (cross-cutting).

Overview of performance in 2010/11

51. Over the year, as recorded in the Commissioner's Annual Report, which was published in July 2011, SRWC undertook a number of initiatives to evaluate and improve their performance. The Annual Report records SRWC's mission/ purpose as: *Through our monitoring and promotional role, seek improvements to the planning, co-ordination and quality of works in roads in Scotland.*
52. The 2010/11 Business Plan had set out the following strategic aims for the Commissioner:
- to monitor the carrying out of works in roads in Scotland
 - to promote compliance with the New Roads and Street Works Act 1991 and obligations imposed under it
 - to promote the pursuit of good practice
 - to undertake dispute resolution as required
 - to ensure the effective operation of the Commissioner's office.

The Business Plans set out how each of the Commissioner's strategic aims will be performed successfully in terms of key deliveries or actions along with timescales; given the nature of the Commissioner's activity in some cases the timescales are "on-going".

53. The Commissioner's Annual Report for 2010/11 records the outturn against the objectives set out in the Business Plan. There were 27 specific objectives set and the Annual Report records comments and outcomes against each. The Commissioner substantially met the key targets relevant to 2010/11. The Annual Report classifies all objectives as met, partially met or not met. For 2010/11, the annual report indicates that 22 were achieved (met), 3 partially achieved (partially met), 1 was not achieved (not met) and 1 was not applicable to the circumstances that arose on 2010/11.

National performance reports

54. Audit Scotland carries out a national performance audit programme on behalf of the Auditor General for Scotland and the Accounts Commission. The findings and key messages of these

studies are published in national reports. One report in the last year of direct interest is *'Maintaining Scotland's Roads'*.

Maintaining Scotland's Roads

55. The central recommendation of the Audit Scotland Report "Maintaining Scotland's Roads" published February 2011, was "The Scottish Government should consider a national review on how the road network is managed and maintained, with a view to stimulating service redesign and increasing the pace of examining the potential for shared services."
56. The Scottish Roads Maintenance Review was announced in March 2011. As part of it the Commissioner was tasked by the Minister for Transport to specifically consider the way in which utility works are currently completed, the possible long term damage which utility works might cause, and the use of existing legislation to ensure utility companies contribute to the costs of making good such long term damage. The Review outcomes and SRWC involvement will be reported in the Commissioner's next Annual Report.

Outlook

57. SRWC should continue a programme of self evaluation and review of their management arrangements with a view to continuous improvement of performance. As part of this process SRWC should have regard to the outcomes of Audit Scotland's programme of performance audits, and consider Best Value self assessment toolkits, as appropriate to their circumstances.

Appendix A: Action Plan

Key Issues/ Risk Areas and Planned Management Action

Action Point	Issue/ Risk Identified	Planned Management Action	Responsible Officer	Target Date
1 Para 24	<p>Review of contracting for the Scottish Road Works Register</p> <p>We welcome SRWC's post completion review of the exercise for letting and implementing the new contract.</p> <p>Risk: Costs associated with re-letting and implementing the contract may afford scope for savings which are best identified in light of recent current experience.</p>	<p>SRWC will review the recent exercise, discuss with SG and others as appropriate, and record any lessons learned or issues to be explored for future contracts.</p>	Commissioner	30 June 2012