

Public Audit Committee

12th Meeting, 2023 (Session 6), Thursday, 27 April 2023

The 2021/22 audit of Ferguson Marine Port Glasgow (Holdings) Limited

Introduction

1. At its meeting today, the Public Audit Committee will take evidence from the Auditor General for Scotland (AGS) on his section 22 report, [The 2021/22 audit of Ferguson Marine Port Glasgow \(Holdings\) Limited](#), which was published on 14 March 2023.
2. The AGS has prepared a note on the key messages from the report which, along with a copy of the report, can be found in the Annexe.
3. The Committee will decide any further action it wishes to take after it has taken evidence from the AGS.

**Clerks to the Committee,
24 April 2023**

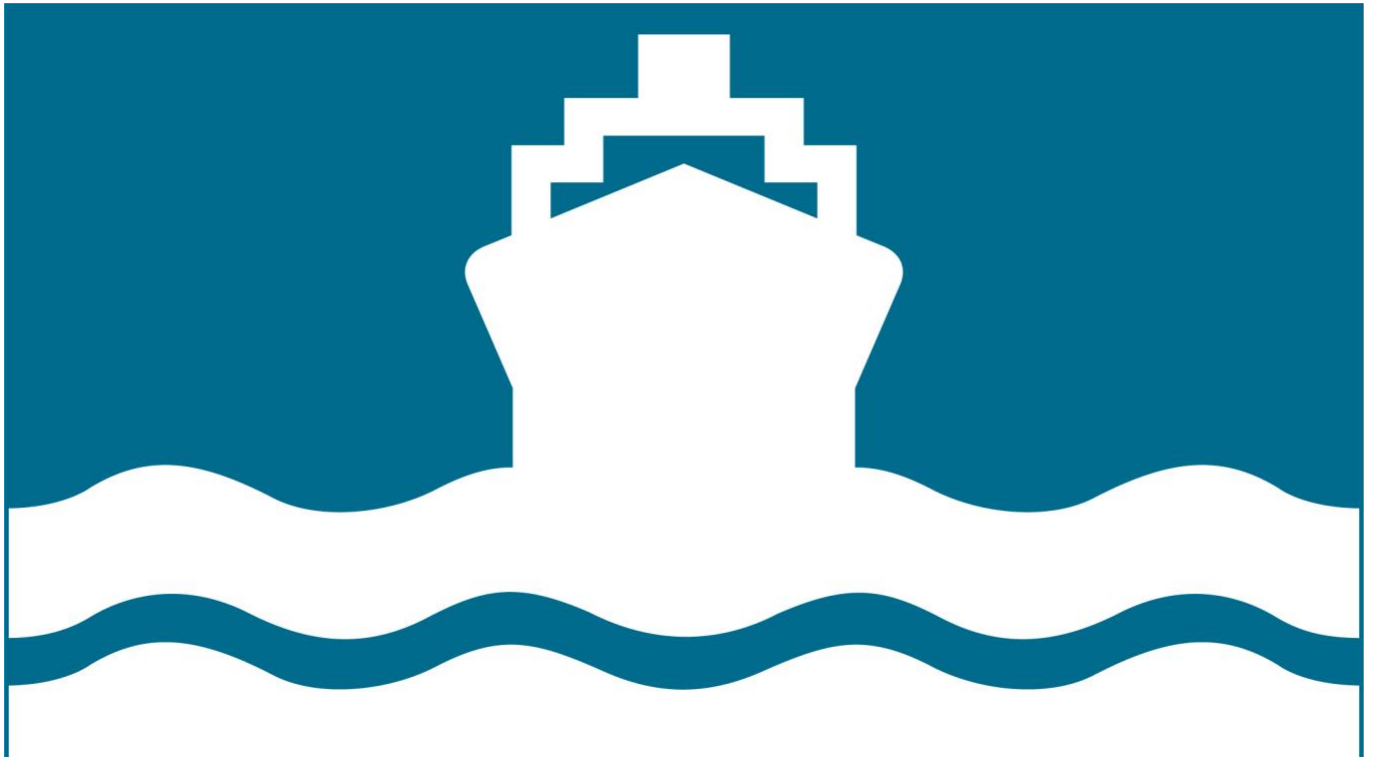
BRIEFING PAPER BY THE AUDITOR GENERAL FOR SCOTLAND

1. The Auditor General's Section 22 report on the 2021/22 audit of Ferguson Marine Port Glasgow (Holdings) Limited was published on 14 March 2023.
2. This report highlights a number of issues and risks identified by the auditor during the course of their audit. The auditor issued an unqualified opinion on FMPG's 2021/22 financial statements but highlighted some risks and uncertainties to its financial viability within their audit certificate. This reflected the uncertainties identified by FMPG's Directors in their assessment of the organisation's ability to operate as a going concern.
3. Key messages from the report are:
 - The final cost of vessels 801 and 802 remains uncertain. The Scottish Government increased FMPG's 2022/23 capital funding by £27.7 million to £61.1 million and a further £57.6 million is allocated in the 2023/24 budget approved by Parliament. Current FMPG estimates suggest around £9.5 million more will be required to fund the vessels, beyond the amount already approved. This would bring the total cost to £293 million. Remaining costs will need to be considered as part of future budget processes.
 - The Scottish Government issued a letter of comfort to the FMPG Board in December 2022. This provided assurances that the Scottish Government intends to continue to support FMPG financially for at least 12 months from February 2023 to deliver the two vessels and in securing a sustainable future for the yard. This is subject to Parliamentary approval of funding and due diligence of funding requests.
 - The Scottish Government commissioned an independent review of FMPG's estimate of costs. This concluded that FMPG's cost estimates are reasonable but more contingency needs to be built in as risks still remain.
 - There remains uncertainty about the longer-term sustainability of FMPG. Further investment in FMPG and its workforce will be required for it to be able to secure future contracts once it has completed vessels 801 and 802. Working together, FMPG and the Scottish Government need to establish and clarify plans for the future of the yard as soon as possible.
 - Performance related bonus payments of £87,000 were made to the senior management team during 2021/22. Appropriate frameworks and governance were not in place and it is not sufficiently clear how performance was assessed. FMPG did not inform, or seek approval from, the Scottish Government for these payments. It should have done so as a matter of good practice and governance. The Scottish Government has now put arrangements in place aimed at ensuring this does not happen again.

4. The Chief Executive of FMPG provided his [quarterly update](#) to the Parliament's Net Zero, Energy and Transport Committee on 16 March 2023. This confirmed further delays to the vessels. FMPG now aims to complete Glen Sannox 801 by autumn 2023 and no later than the end of 2023, and complete vessel 802 by late summer 2024 and no later than the end of 2024. The Chief Executive also stated that FMPG are holding to the overall 'build to complete' budget previously set out.
5. In his [statement](#) on 16 March 2023, the former Deputy First Minister confirmed that the Scottish Government's full assessment and due diligence of the FMPG's cost estimates was due to complete soon. He also confirmed that he has written to the Chief Executive to notify him that the Scottish Government is considering his proposals and will confirm its position in due course.

The 2021/22 audit of

Ferguson Marine Port Glasgow (Holdings) Limited



AUDITOR GENERAL 

Prepared for the Public Audit Committee by the Auditor General for Scotland
Made under section 22 of the Public Finance and Accountability (Scotland) Act 2000

March 2023

Introduction

1. I have received the audited annual report and accounts and the independent auditor's report for Ferguson Marine Port Glasgow (Holdings) Limited (FMPG) for 2021/22. I am submitting these financial statements and the auditor's report under section 22(4) of the Public Finance and Accountability (Scotland) Act 2000, together with this report that I have prepared under section 22(3) of the Act.

2. The auditor issued an unqualified opinion on FMPG's financial statements for 2021/22. The auditor has highlighted some risks and uncertainties to the financial viability of FMPG within their audit certificate. I have prepared this report to draw the Scottish Parliament's attention to these matters.

Key messages

- 1** The final cost of vessels 801 and 802 remains uncertain. The Scottish Government increased FMPG's 2022/23 capital funding by £27.7 million to £61.1 million and a further £57.6 million is allocated in the 2023/24 budget approved by Parliament. Current FMPG estimates suggest around £9.5 million more will be required to fund the vessels, beyond the amount already approved. This would bring the total cost to £293 million. Remaining costs will need to be considered as part of future budget processes. FMPG will update Parliament on progress before the end of March 2023.
- 2** The Scottish Government issued a letter of comfort to the FMPG Board in December 2022. This provided assurances that the Scottish Government intends to continue to support FMPG financially for at least 12 months from February 2023 to deliver the two vessels and in securing a sustainable future for the yard. This is subject to Parliamentary approval of funding and due diligence of funding requests.
- 3** The Scottish Government commissioned an independent review of FMPG's estimate of costs. This concluded that FMPG's cost estimates are reasonable but more contingency needs to be built in as risks still remain.
- 4** There remains uncertainty about the longer-term sustainability of FMPG. Further investment in FMPG and its workforce will be required for it to be able to secure future contracts once it has completed vessels 801 and 802. The Scottish Government has commissioned an independent review of future options for the yard, which is ongoing. Working together, FMPG and the Scottish Government need to establish and clarify plans for the future of the yard as soon as possible.

- 5 FMPG has highlighted the remaining risks and uncertainties appropriately within its 2021/22 annual report and accounts. The auditor's opinion includes a paragraph to draw people's attention to these matters.
 - 6 Performance related bonus payments of £87,000 were made to the senior management team during 2021/22. Appropriate frameworks and governance were not in place and it is not sufficiently clear how performance was assessed. FMPG did not inform, or seek approval from, the Scottish Government for these payments. It should have done so as a matter of good practice and governance. The Scottish Government has now clarified its expectations and requirements of FMPG in relation to public sector pay policies and rules.
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Background

3. In December 2019, the Scottish Government brought the Ferguson Marine shipyard in Port Glasgow into public ownership after it had been placed into administration. This created a new entity, Ferguson Marine (Port Glasgow) Holdings Limited (FMPG). FMPG is a Non-Departmental Public Body wholly owned by the Scottish Government. Scottish ministers are the sole shareholder for FMPG, holding one ordinary share of £1.
4. After FMPG was established, the existing contracts with Caledonian Maritime Assets Limited (CMAL) to build two ferry vessels, the Glen Sannox-801, and 802, for the Scottish Government were transferred to the new entity to deliver. In March 2021, after consideration of different funding options, the Scottish Government finalised the arrangements to fund and manage the vessels. This included replacing the existing contract between CMAL and FMPG with a new contract for each vessel.
5. The restructuring of the contracts means that the vessels, as assets, are owned by the Scottish Government. As a result, vessels 801 and 802 are not recorded on FMPG's financial statements but sit on the Scottish Government's consolidated balance sheet as Assets Under Construction at a value of £74 million. The costs incurred in building 801 and 802, and the Scottish Government funding to cover them, are included in FMPG's financial statements.
6. I previously reported on the [New vessels for the Clyde and Hebrides](#) and the arrangements to deliver these vessels in March 2022. I also reported on the Scottish Government's decision to bring the Ferguson Marine shipyard into public ownership in my December 2021 report on the [2020/21 audit of the Scottish Government Consolidated accounts](#). I provided a further update on FMPG in my December 2022 report on [2021/22 audit of the Scottish Government Consolidated accounts](#).

The final cost of vessels 801 and 802 remains uncertain. Current FMPG estimates suggest further funding of around £9.5 million may be required, meaning a total cost of £293 million

7. FMPG's strategic report (pages 4 and 5), within its 2021/22 annual report and accounts, provides the company directors' assessment of going concern. This highlights the risks and uncertainties over current and future contracts and funding. The auditor included a paragraph within their audit certificate (opinion) on FMPG's annual report and accounts to draw attention to these matters.

8. The auditor considered FMPG's ability to continue as a going concern for a 12-month period beyond the date of signing the 2021/22 audit report in February 2023. The auditor's judgement took into consideration:

- Management's own assessment of going concern and discussion with them.
- Review of cash flow forecasts for the next 12 months including estimates made by management.
- A letter of comfort issued by Scottish Government to the FMPG Board in late December 2022. The letter of comfort provides the company directors with formal assurance that the Scottish Government will provide financial support to ensure the company can meet its obligations for a standard period of at least 12 months after the accounts were approved.
- The Scottish Government's 2023/24 Draft Budget on 15 December 2022.

9. The timeline, anticipated at the time of the original contract with FMPG was for 801 and 802 to be delivered by April 2022 and December 2022 respectively.

¹ The revised target dates for delivery are May 2023 for 801 and March 2024 for 802.² The Chief Executive Officer (CEO) of FMPG is due to give his quarterly update on progress to the Scottish Parliament before the end of March 2023.

10. [Exhibit 1](#) sets out FMPG's spending to date on the 801 and 802 and its estimated costs of the vessels. My March 2022 report stated that £83.25 million had been spent on building the vessels prior to the shipyard coming into public ownership.³ Based on FMPG's current estimates this means the total cost of the vessels is now expected to be around £293 million.

¹ The expected delivery dates for the original contract between CMAL and Ferguson Marine Engineering Limited was May 2018 for 801 and July 2018 for 802.

² 2021/2022 Ferguson Marine (Port Glasgow) Holdings Limited Annual Report and Financial Statements.

³ [New vessels for the Clyde and Hebrides report \(page 102 and 147\) Audit Scotland, March 2022.](#)

Exhibit 1**Current estimated cost of vessels incurred by FMPG**

	£ million
Estimated cost of vessels 801 and 802 to FMPG (including warranties) *	209.6
Total spending by FMPG on 801 and 802 up to 31 March 2022	81.4
Allocated in 2022/23 budget and subsequent revisions	61.1
Allocated in 2023/24 budget	57.6
Potential future funding requirement yet to be considered	9.5

* [Letter from Chief Executive Officer of FMPG to the convener of the Scottish Parliament Net Zero, Energy and Transport Committee, 28 September 2022](#). This is the upper amount of the estimated range of £197.4 million to £209.6 million. Potential warranty costs of £7 million are included in this amount. These are costs that could be incurred after the ferries are completed if any parts are found to be defective or need replaced.

11. FMPG's total estimated cost for 801 is £101 million, and £108.6 million for 802.⁴ During 2022, the Scottish Government commissioned an independent consultant to review FMPG's financial forecasts and key assumptions to complete 801 and 802.

12. This work concluded in December 2022 and found that forecasting undertaken by FMPG was reasonable, but there were a number of assumptions and uncertainties that also needed to be factored in. These included:

- the need to build in more contingency into estimates, given the history to date and profile of increasing costs. FMPG's September 2022 estimate included a contingency of £6.2 million which the independent review considered to be too low.
- the extent to which any remaining design and delivery risks would lead to further rework and the costs which could be clawed back.

⁴ [Letter from Chief Executive Officer of FMPG to the convenor of the Scottish Parliament Net Zero, Energy and Transport Committee, 28 September 2022](#)

- increasing costs and general supply chain pressures within the construction sector are likely to continue to impact on costs and timescales.

13. During October to mid December 2022, FMPG made expenditure commitments of between £10 and £15 million more than the Scottish Government had allocated it for 2022/23 at that point. FMPG was uncertain whether the Scottish Government would fund these committed costs and sought retrospective assurances. The Scottish Government issued a letter of comfort to the FMPG Board in December 2022. This provided assurances that it intends to continue to support FMPG financially for at least 12 months from February 2023 (the support period) to deliver the two vessels and secure a sustainable future for the yard. This is subject to Parliamentary approval of funding and Scottish Government due diligence on funding requests from FMPG.

14. The Scottish Government also announced additional funding of £15 million in December 2022 and a further £6 million in February 2023, increasing FMPG's capital budget to £61.1 million for 2022/23 ([Exhibit 1](#)). The Scottish Government would have to manage any additional funding required in 2023/24 and potentially 2024/25 within its overall budget. Based on FMPG's September 2022 estimate of final costs, this suggests there may be a future funding requirement of around £9.5 million which would have to be considered in future budget rounds.

There are risks and uncertainties to the longer-term financial viability of FMPG

15. The company directors' assessment of going concern also identified risks and uncertainties relating to the longer-term funding and financial viability of FMPG. These are highlighted by the auditor in their audit certificate with further details provided in their [annual audit report](#).

16. Currently, FMPG's main source of income is Scottish Government funding to cover the costs to deliver 801 and 802. The letter of comfort provided to the board in December 2022 confirms that funding will be provided during the support period. Any future public funding required will need to be approved, subject to due diligence, through future Scottish Government Budgets and revisions.

17. FMPG's only other commercial income has been from a contract with BAE relating to the secondment of 18 employees from FMPG to work in BAE's Govan shipyard. There are uncertainties within FMPG's cashflow estimates relating to this income and FMPG's ability to win future contracts.

18. FMPG is considering future business plans and what further investment is needed for it to be competitive and secure future contracts. The level of investment that is likely to be required for these purposes has not been confirmed by FMPG or the Scottish Government.

19. The amount of investment ultimately required to maintain FMPG as a going concern will depend on decisions about its future operating model and workforce requirements. Currently, FMPG's workforce, while skilled, is ageing

and it is being supplemented by the use of contractors. FMPG has reported that there are limited shipbuilding skills available in Scotland and that, to date, it has been unable to compete effectively with the private sector for skilled staff. This has implications for future costs and FMPG's ability to secure and deliver future contracts. FMPG's committed salary costs have increased during 2022/23. Rising energy and supply chain costs will also continue to put pressure on FMPG's budget.

20. At the time of the conclusion of the annual audit in February 2023, the outcome of the review commissioned by the Scottish Government to assess both funding and future options for FMPG had not yet been published. It is important that the Scottish Government concludes this review and clarifies its future approach as soon as possible to provide more certainty to FMPG and its staff.

There was insufficient transparency and poor governance over bonuses paid to FMPG's senior management team

21. In 2021/22, performance related bonuses were paid to six employees, totalling £87,000.

22. The senior management team employed in 2019, when FMPG came into public ownership, held employment contracts containing a clause entitling them to a performance related bonus of up to 20 per cent of their base salary. However, there was no performance management framework of key performance indicators (KPIs) which set out how performance would be assessed or measured.

23. Payment was approved by **FMPG's Remuneration Committee** based on a paper prepared by the former Turnaround Director in February 2022. This recommended that 7.5 per cent should be paid on the delivery of milestones determined by FMPG. The remaining ten per cent paid was discretionary based on performance. A letter from the Turnaround Director to each Director confirmed this performance related bonus was payable as a result of the structural completion of the hull on vessel 801.

24. There was a lack of transparency and good governance around the assessment and approval of these payments. FMPG was unable to evidence the evaluation over the discretionary element of this payment. The Scottish Government was not made aware of these bonus payments, and they were not subject to approval by the sponsor department.

25. I would consider it as a matter of good practice and governance for FMPG to have sought advice and approval from the Scottish Government in this case.

FMPG's Remuneration Committee membership consists of: the Chair of the Board, two Non-Exec Board members and the Turnaround Director.

Other pay arrangements

26. FMPG's Framework Agreement includes an overall framework for pay. It was not formally agreed until March 2022, after bonus payments were approved. Prior to that, FMPG was not sufficiently clear what the Scottish Government's requirements and expectations of it were in respect to pay.

27. While FMPG is not required to comply with all rules on public sector pay and conditions, any significant departures from these now explicitly requires Scottish Government approval. The Framework Agreement provides that 'FMPG maintain regular dialogue with the SG Finance Pay Policy on any proposals with an expectation that these will be broadly consistent with the provisions of SG Pay Policy and Staff Pay Remit. Any significant deviations will require further approval'. While the Framework Agreement itself does not clearly define what it considered as being 'broadly consistent' or a 'significant deviation', the Scottish Government provided clarification to FMPG in February 2023.

28. The Scottish Government appointed a Turnaround Director in August 2019. He left the role in February 2022. During 2021/22 FMPG paid remuneration of £591,232 and expenses of £70,102 for his services. This brought the total cost of this arrangement to around £1.8 million. No bonus was paid to the Turnaround Director during 2021/22.

29. FMPG appointed a permanent Chief Executive in February 2022. The recruitment process was supported by an external recruitment agency with salaries benchmarked, with similar industries. The appointment of the Chief Executive was made by the FMPG Board, with Scottish Government approval. The salary and overall employment package were also authorised by the Scottish Government. This includes a base salary of £205,000 alongside a potential performance related bonus of up to 40 per cent of base salary, based on KPIs. At the time of appointment, there was not yet a KPI framework established, to assess performance. No bonus was paid to the Chief Executive in 2021/22.

FMPG has subsequently approved a pay performance framework but this is yet to be approved by the Scottish Government

30. The FMPG Remuneration Committee approved a performance framework for both Senior Managers and the Chief Executive in November 2022. At the time of reporting this had not yet been discussed with, or approved by, the Scottish Government.

31. The performance framework sets out criteria based upon the project plan and the delivery of key milestones. Payments would be made in instalments during 2023/24. It is important that FMPG seeks approval from the Scottish Government for this framework and that appropriate governance arrangements are agreed.

Conclusions

32. FMPG continues to face significant challenges in delivering vessels 801 and 802. It will shortly provide the Scottish Parliament with an update on progress.

33. There are uncertainties about FMPG's future funding and its ability to secure contracts after the existing contracts are completed. This presents risks to the longer-term viability of FMPG. The Scottish Government has commissioned an independent review to assess this. Working together, FMPG

and Scottish Government need to establish and clarify plans for the future of the yard as soon as possible.

34. There was insufficient transparency and governance over bonus payments of £87,000 made to FMPG's senior management team during 2021/22. FMPG needs to ensure transparency and good governance in all the decisions that it makes and ensure that they demonstrate value for money. The Scottish Government has since clarified its requirements on pay and will need to make sure these are appropriately applied.

35. I will continue to monitor progress with the delivery of the two vessels, and the ongoing reviews, and will consider further reporting in public as necessary.

The 2021/22 audit of

Ferguson Marine Port Glasgow (Holdings) Limited

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