



Grant Thornton

Scottish Canals

**External Audit Annual Report to the Board and the Auditor General for
Scotland**

2018/19 Financial Year

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Financial statements audit at a glance



We have fulfilled our responsibilities as set out in International Standards on Auditing (ISAs) (UK) and the Audit Scotland Code of Audit Practice throughout our work and this final report to the Board and the Auditor General for Scotland concludes our work.



As set out in our plan, our materiality calculations were based on the audited 2017/18 financial statements and have been updated to reflect the 2018/19 draft financial statements. Overall materiality has been set at £300,000 (1.7% of gross expenditure).



We have performed audit testing around our identified areas of significant risk: management override of controls; the risk of fraud in revenue recognition; the risk of fraud in expenditure recognition; and the valuation of the Dundas Hill development. Given that there has been no change in planned use of the development and that expenditure incurred is in line with projected development cost, we are satisfied that the recognition of Dundas Hill as work in progress remains appropriate.

An audit underpinned by quality



Whilst we did not identify any material adjustments to the financial statements there are opportunities to enhance the quality and completeness of the draft annual accounts presented for audit, including the final quality checks undertaken by management on the annual report and accounts.



Scottish Canals is currently established as a Public Corporation. In line with the Accounting Direction, which recognises the public corporation status of Scottish Canals, its principle accounting framework is aligned with the Companies Act. We note that the Office of National statistics (ONS) information implies that Scottish Canals should be an NDPB. Scottish Canals should discuss their classification, and then future accounting requirements, with the Scottish Government to ensure their public body classification is correct and this then aligns to their accounting framework.

Summary of our wider scope audit findings

In accordance with the Code of Audit Practice our audit work includes consideration of Scottish Canals arrangements in respect of the wider scope audit dimensions: financial management; financial sustainability; governance and transparency; and, value for money. Our considerations are aligned to risks and significant developments during the financial year.

The 2018/19 financial year represented a challenging period for Scottish Canals. During 2018/19, Scottish Canals incurred an operating deficit of £918,000 against a budgeted surplus of £150,000. This reflects underlying operational challenges faced in delivering the Corporate Plan including maintenance and investment in the canal infrastructure. Over the medium to longer term, Scottish Canals face more significant financial and strategic challenges. Management have forecast shortfalls in the finance required to continue to support the necessary investment in the canals infrastructure with a current estimated repair, maintenance and investment backlog of £70 million. While Scottish Canals continue to seek additional revenue through commercial enterprises, these, alongside anticipated static levels of Scottish Government finance, are forecast to be insufficient to meet the level of investment needed to maintain the canal infrastructure. As seen during 2018/19 Scottish Canals are reliant on one off capital funding to support significant asset failures and maintain certain canal assets.

With the development of the Corporate Plan 2020-23, Scottish Canals face key decisions around the vision and strategic direction of the organisation. A key element of this will be the planned and ongoing funding of strategic investments, including Dundas Hill. From review of Board minutes and papers during 2018/19 we found that investment activity was reported throughout the year through quarterly dashboards. As Scottish Canals matures as an organisation, there is an opportunity to develop an overall framework for monitoring and reviewing strategic investments and their performance against planned outcomes. This will enable future investment decisions to not be taken in isolation and full consideration of whether they are aligned to the wider investment priorities of the organisation.

During the year there have been significant changes across the Scottish Canals Board. Since March 2018, the only remaining member of the six person Board (including Chief Executive) is the Chair. The Chair's term of appointment is due to end in March 2020. The level of change of board membership during the year has put at risk the effectiveness of scrutiny and governance arrangements at Board and Committee level. One example of this is that the Audit and Risk Committee in June consisted of only one non-executive member who had attended a previous meeting with other non-executives and co-opted members being new to the organisation, limiting corporate knowledge and understanding of the business during the year and consequently assurances to the Board in respect of the annual report and accounts. We understand the previous Audit Committee chair offered to stay with Scottish Canals to chair the June Committee but this was felt unnecessary by the Board Chair and they subsequently left in April 2019.

In May 2018 the former Chief Executive left the organisation and an interim secondment option was put in place to provide cover before a recruitment exercise could commence. The recruitment process ran from June 2018 to August 2018. In June 2018 the advert for the Chief Executive post was amended to include the option for individuals to apply on a secondment basis, for a minimum of 3 years. In September 2018 we understand the Board decided to appoint the then current interim Chief Executive into the role. There was a lack of clarity over whether this appointment was on a secondment basis or permanent. Following discussions between the Board Chair and the Interim Chief Executive we note an updated secondment agreement was put in place dated January 2019, 3 months after the appointment announcement, to cover a one year period only, up until December 2019. The letter made it clear there would be no extension to this agreement. The announcement by the Board Chair in September 2018 and all references to the Chief Executive role on Scottish Canals publications and website imply that the post was a substantive permanent appointment, rather than an interim secondment. The Accountable Officer letter from Scottish Government stated "Interim Accountable Officer".

At the end of May 2018, the Remuneration Committee notes the decision to commence a new recruitment exercise for a permanent Chief Executive, and this was communicated across the organisation. In early June, following discussions between the Interim Chief Executive and their employer, Scottish Prison Services (SPS) we note correspondence which sets out the interim Chief Executive was keen to continue their secondment to Scottish Canals. Following personal correspondence between the interim Chief Executive and SPS, discussions took place with the Board Chair. As part of these discussions it was agreed to extend the secondment to 2023. Between early June and end of June dialogue happened between the Board Chair and the Board members, either by calls or via emails to approve the decision to extend the contract. We managed to obtain some of this correspondence, but no formal records were held to support the decisions that were taken. We have not seen any documentation which considers the financial implications of this decision for Scottish Canals, an evaluation of what has changed since the previous commitment in May to recruit and an evaluation of all options available to Scottish Canals, including considering the skills and experience required by the Chief Executive aligned to the organisations objectives.

The timeline for the appointment process, alongside supporting commentary based on the available audit evidence is set out in Appendix A.

Based on our review, and the available supporting documentation, we conclude that there is inadequate governance and transparency over the Board decision making process, first for the initial recruitment, including how the Board reached a decision on a secondment appointment and then the following decisions in May and early June to extend the secondment through to 2023.

There was no appraisal undertaken at any point in the decisions taken, considering the various options available to Scottish Canals and how the subsequent decisions represented value for money. Over the time frame the recording of decisions within the Board minutes and also remuneration committee meetings is poor, and any supporting discussions that took place out with committee via email was either not retained, or if available not held centrally.

There is no evidence available to support the interview and decision process made in the recruitment exercise in June through to August 2018 as we have been informed there were no notes retained and no report outlining panel recommendations and decisions. Lastly throughout this process it is unclear how independence and potential conflicts of interest have been managed.

Looking forward, given the level of change in the Board during 2018/19 as well as planned change in 2019/20, it is important that the Board is satisfied that it has the right balance of skills and experience to deliver effective governance. Depending on the strategic direction Scottish Canals take, there is an opportunity for the Board to reflect on the existing governance arrangements in place to ensure that it has the right size, structure and membership to ensure effective leadership and governance.

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Introduction

Reporting

This report is a summary of our findings from our external audit work for the financial year ended 31 March 2019.

Our work has been undertaken in accordance with International Standards of Auditing (ISAs) (UK) and the Audit Scotland Code of Audit Practice 2016.

Our report is addressed to the Board of Scottish Canals. In addition, in accordance with our reporting responsibilities the report is jointly addressed to the Auditor General for Scotland.

Once finalised this report will be made publically available on the Audit Scotland website (www.audit-scotland.gov.uk)

Our report was presented as a draft to the Scottish Canals Audit and Risk Committee on 12 June 2019. Due to a lack of clarity around governance arrangements around the appointment of the Chief Executive on secondment to 2023, the updated report was presented to the Audit and Risk Committee on 5 August 2019, and then to the Board on the 29th of August 2019. The annual report and accounts were signed on the 3rd of September 2019.

We would like to thank Scottish Canals' Management and the finance team for their support and assistance during the year-end audit process.

Structure of this report

In accordance with the Audit Scotland Code of Practice, in addition to our core financial statements audit we provide conclusions on the four dimensions of wider-scope public audit. Our report is structured as follows:

Financial statements – Section 1

Financial management – Section 2

Financial sustainability – Section 3

Governance and transparency – Section 4

Value for money – Section 5



Our Opinion

For the financial year ended 31 March 2019 we have issued an **unqualified audit opinion**

- True and fair view of the financial statements
- Regularity – expenditure has been incurred in accordance with the purpose of the Scottish Canals
- Other prescribed matters (which include the audited information in the remuneration report)



The audit process

The draft financial statements were received within agreed timescales. While we did not identify any material errors within the financial statements, there were some delays in finalising the audit. These were due to absence within the finance team as well as Management updates to the Annual Report, including Directors report which required further audit inspection therefore final audit review is outstanding. The quality checks on the final version of the annual report and accounts could be further improved to avoid typing and casting errors.



We identified two audit adjustments to the primary statements including overstatement of accruals and expenditure. We also identified an estimation difference with regards the defined benefit pension scheme recognition, disclosure adjustments to the Remuneration report with regards staff numbers as well as minor disclosure adjustments within the notes to the financial statements (Appendix 2).

Our financial statements audit



We updated our materiality assessment to reflect the draft financial statements. Materiality is set at £300,000, which based on our professional judgement of the value, that if misstated, would influence the economic decisions of the user of the accounts. Materiality is set against a benchmark of gross expenditure, suitable for public sector bodies. It remains within our acceptable range of between 1-2% of gross expenditure.



The draft financial statements were received within agreed timescales. While we did not identify any material errors within the financial statements, there were some delays in finalising the audit. These were due to absence within the finance team as well as Management updates to the Annual Report, including Directors report which required further audit inspection.



We have issued a true and fair audit opinion on the financial statements, including the wider information contained in the financial statements, and regularity opinion. The audited parts of the Directors Remuneration Report are free from error.



Testing provided assurance on identified areas of significant audit risks and there were no material audit differences arising during the course of our audit. We did not identify any additional significant risks of material misstatement to the financial statements from those identified in our annual audit plan.

Audit approach and materiality

Our audit approach was set out in our annual audit plan presented to the Audit and Risk Committee on 27 November 2018. As set out in our plan, our materiality calculations were based on the audited 2017/18 financial statements and have been updated to reflect the 2018/19 draft financial statements.. Overall materiality has been set at £300,000 (1.7% of gross expenditure) and performance materiality is set at £225,000 (75% of materiality). We report to management any audit difference identified over £11,000 (Trivial as 5% of materiality).

The draft financial statements were received within agreed timescales. While we did not identify any material errors within the financial statements, there were some delays in finalising the audit. These were due to absence within the finance team as well as Management updates to the Annual Report, including Directors report which required further audit inspection. In addition, management's final quality checks could be improved on the final annual report and accounts version to eliminate typing errors, alongside casting errors. We will continue to work with management going forward to continue to enhance the audit process.

Audit opinion

Based on our audit procedures performed we have issued an unqualified audit opinion on the financial statements including:

- give a true and fair view in accordance with the Transport Act 1962 and directions made thereunder by the Scottish Ministers of the state of the body's affairs as at 31 March 2019 and of its deficit for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Transport Act 1962 and directions made thereunder by the Scottish Ministers.
- the wider information contained in the financial statements, e.g. Performance Report and Governance Statement, is consistent with the financial statements
- regularity of expenditure
- audited parts of the remuneration and staff report have been prepared in accordance with applicable guidance

Internal control environment

During the year we sought to understand Scottish Canals' overall control environment (design) as related to the financial statements. In particular, we have:

- Sought to understand procedures and controls around related parties, journal entries and other key entity level controls
- Performed procedures around entity level controls and there are no significant matters that we wish to draw to your attention.
- Performed walkthrough procedures on key controls around identified risk areas including revenue, expenditure, property, plant and equipment (PPE) as well as developing our understanding of Dundas Hill project.

No material weaknesses in the accounting and internal control systems were identified based on our work undertaken during the audit which could have an adverse impact on Scottish Canals' ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements. We adopted a substantive based approach to the audit of the financial statements and therefore do our review is limited to the design of controls rather than the operating effectiveness of these.

Internal Audit

As set out in our external audit plan we have not placed formal reliance on the work of Audit Glasgow, the internal audit provider, during 2018/19. We have reviewed the internal audit plan and individual reports issued to date, to consider if any impact on our audit approach. For 2018/19, Internal Audit's opinion conclusion

“Scottish Canals has a system of internal control designed to manage risk to a reasonable level. Internal controls cannot eliminate the risk of failure to achieve policies, aims and objectives and can therefore only provide reasonable and not absolute assurances of effectiveness. As part of our reviews we have identified improvements to the internal control environment, which have been accepted by management. We will monitor the implementation of these improvements through future follow up audits. Our work on the asset management arrangements, in particular, identified a number of actions requiring urgent management action. The issues relate to the monitoring of the delivery of the Asset Management Strategy, the Asset Management Plan and the progress made on high risk assets and the implementation of mitigating actions for high risk assets. In addition our establishment visits have continued to identify a number of areas of non-compliance with corporate procedures. We will report back to management and the Audit and Risk Committee on the implementation of these recommendations during 2019/20.

A key part of the governance arrangements in an organisation is having a stable Board and senior officer structure in place. As part of our audit work in 2018/19 we have noted that there has been a high turnover in Board Members with vacancies currently on the Board. In addition the Chief Executive is an interim appointment.

Based on the audit work undertaken and the assurances provided by the Executive Team it is our opinion that, with the exception of the issues noted above, reasonable assurance can be placed upon the adequacy and effectiveness of the governance and control environment which operated during 2018/19 within Scottish Canals.

The conclusions reached by Internal Audit are not inconsistent with our own conclusions, particularly around governance arrangements in place at Scottish Canals. While the findings do not impact on our overall audit approach or opinion, we have taken these into consideration when making our wider scope audit conclusions where relevant.

Adding value through our external audit work

Our overall objective is to ensure we deliver a quality external audit which fully complies with International Standards of Auditing (ISAs) UK and the Audit Scotland Code of Practice (2016). By ensuring our audit is efficient and effective, gives you assurance over our opinion.

Through this Annual Report we seek to provide insight and commentary over certain aspects of Scottish Canals' arrangements, sharing relevant practices with the Audit and Risk Committee and Management.

During 2018/19, we have added value through our audit work and engagement through the following arrangements:

- Audit Engagement Lead attendance at Audit and Risk Committee meetings throughout the year to provide insight and challenge across the financial year
- Early engagement, interaction with Management, and audit testing over new or emerging technical accounting issue or standards including IFRS 15 and IFRS 9
- Engagement Lead meetings with Interim Chief Executive and Chair of Scottish Canals during the financial year to develop our knowledge and understanding of the organisation and support our wider scope audit work.



Update on our audit work

Within our annual external audit plan we identified significant audit risks and our planned approach. We have set out below a summary of the work undertaken over these risks and our audit conclusions

	Identified audit risk at planning	Work completed	Our conclusion
Risk of fraud in revenue	<p>As set out in ISA 240 there is a presumed risk that revenue may be misstated due to improper recognition of revenue. Scottish Canals anticipates grant in aid funding from the Scottish Government of £12.4 million, of which £8.1 million related to revenue. We consider this transaction stream to be well forecast and agreeable to third party confirmation and therefore rebut the presumed risk of improper recognition. Scottish Canals' main revenue comes from sales of goods as well as rendering of services. During 2017/18, Scottish Canals generated £9.3 million from these revenue streams. Scottish Canals' financial performance is measured through its outturn position at year end. We consider the risk to be prevalent around the year end where there is greatest incentive and opportunity for manipulation and therefore focus our testing on existence of debtor balances at the year end and cut-off.</p>	<ul style="list-style-type: none"> Developed our understanding of Scottish Canals' material revenue streams including walkthrough of key transactions. Performed audit testing of key revenue streams during the year, with a focus on year end transactions to ensure that income relating to 2019/20 was not recognised in 2018/19. This included analytical procedures and transaction testing Performing revenue cut off procedures and substantive testing around year end transactions and balances to ensure revenue recognised around the year end and recognised in the financial statements was genuine 2018/19 revenue Testing the existence and recoverability of balances at the year end 	<p>From our audit procedures performed we are satisfied that revenue is free from material misstatement. We are satisfied that revenue has been recognised in the appropriate financial year.</p>
Operating expenditure is not treated correctly	<p>Operating expenditure is understated or not treated in the correct period (risk of fraud in expenditure). As set out in Practice note 10 (revised) which applies to public sector entities. As payroll expenditure is well forecast and agreeable to underlying payroll systems there is less opportunity for the risk of misstatement in this expenditure stream. We therefore focus on non-pay expenditure. We consider the risk to be particularly prevalent around the year end and therefore focus our testing on cut-off of non-pay expenditure.</p>	<ul style="list-style-type: none"> Developed our understanding of Scottish Canals' material expenditure streams including walkthrough of key transactions. Performing audit testing of key expenditure streams during the year, including analytical review of expenditure and targeted transaction testing, including consideration of the regularity of expenditure incurred, to ensure Performing cut-off testing of expenditure transactions around the year end to ensure these had been allocated to the appropriate financial year. Reviewing post year end payments for any potential unrecorded liabilities. 	<p>Adequate assurance gained that expenditure has been recorded within the appropriate financial year and that payables are free from material misstatement. We are satisfied that expenditure has been incurred in accordance with the type/nature of Scottish Canals as an organisation.</p>

	Identified audit risk at planning	Work completed	Our conclusion
Management override of controls	<p>As set out in ISA 240 there is a presumed risk that management override of controls is present in all entities</p>	<ul style="list-style-type: none"> • Developed our understanding of how/where management override of controls may occur • Review of the controls over journal entries using our journal analyser tool to focus on higher risk journals • Understanding key areas of judgement and accounting estimates within the financial statements and the basis for these judgements and the application of accounting policies. This include assumptions around IAS 19 defined benefit obligations. • Reviewing unusual and/or significant transactions that are out with the normal course of business for the entity to understand the rationale for these transactions 	<p>We did not identify any significant areas of bias in key judgements by management. We have not identified any unusual or significant transactions during the course of the year that would indicate management manipulation.</p>
Accounting for Dundas Hill	<p>In 2016/17 the Dundas Hill project was accounted for as stock within Scottish Canals balance sheet. As the project develops the accounting treatment may no longer be applicable.</p>	<ul style="list-style-type: none"> • We have reviewed the latest Board's position on the proposed use of Dundas Hill to consider if the current accounting treatment remains appropriate • We have reviewed the expenditure incurred and performed sample testing to ensure that the costs incurred related to ongoing development works and correctly recognised. • We have reviewed the latest financial plans in place and forecast to ensure that the carrying value of the land remains appropriate and that there is no indication of impairment in value. 	<p>We are satisfied that the Dundas Hill development remains as ongoing work in progress and that expenditure incurred during the year has been appropriately recognised. We have considered the current financial plans in place for the site and are satisfied that there is no indication of impairment on the development.</p> <p>As at 31 March 2019, the total work in progress was £7.3 million relating to remediation and infrastructure works invested in the development. Scottish Canals plan to sell the site for housing development. In 2017 Scottish Canals took independent valuation advice from Ryden and Savills on estimated land values including a range of potential values. Management continues to assess these values and satisfied that the investment remains fully recoverable. Management estimate that the lowest forecast potential profit of the development will be £1.6 million.</p> <p>The accounting recognition as work-in-progress is on the basis that the investment in the development is for the purpose of developing the site for future sale. As the project continue to forecast a profitable outturn position then there is currently no indication that the value of the work in progress (net realisable value) has fallen below the current carrying value (cost). It is important that given the current value of the development, Scottish Canals ensure that the overall project expenditure and forecast recovery of investment continue to be kept under review.</p>

Other key areas of the financial statements

As part of our audit there were other key areas of focus during the course of our audit. Whilst not considered a significant risk, these are areas of increased risk due to their complexity or magnitude. This includes areas of key estimation and judgement and application of accounting policies.

Commentary:

Scottish Canals Accounting policies are in accordance with IFRS and Companies Act requirements. These have been applied consistently to the previous year with the exception of the adoption of two new accounting standards IFRS 9 and 15. While these resulted in minor disclosure changes to the accounts, neither of these standards had a material impact on Scottish Canals' primary financial statements.

Accounting estimates and judgements:

Scottish Canals' significant accounting estimates and judgement impacting on the annual accounts are the following:



Investment Properties: Investment properties of £15.989 million were included in the March 2019 accounts. The Investment properties were revalued as at 31 March 2019 on the basis of market value by professional values' Cushman & Wakefield. We have reviewed the basis of the valuation and consider the Scottish Canals' accounting treatment to be appropriate. During 2018/19, the value of investment reduced by £1.4 million. We have reviewed the valuation of investment properties and are satisfied that the reduction in value is in line with market based data. We have reviewed investment valuations and investigated the individual assets who's valuation movement was not in line with other assets in its category. The most significant movement related to the impairment in the value of the investment in land at Auchinstarry property (boathouse restaurant) due to the property valuation reflecting market conditions and viability with there no longer being a tenant on the property.

Defined benefit pension schemes: Scottish Canals participates in two defined benefit pension schemes: The Waterways Pension Fund (WPF) and the Strathclyde Pension Fund (SPF). Both schemes are subject to an actuarial valuation each year to determine Scottish Canals' share of the assets and defined benefit liabilities. The net defined benefit pension liability was £864,000. We have used our in house actuarial specialists to review the reasonableness of the assumptions used within the actuarial valuation as well as reviewing the reasonableness of scheme assets and liabilities.

In December 2018, the Court of Appeal ruled that the transitional protection offered to some members of public sector pension schemes as part of reforms to those schemes amounts to unlawful discrimination (McCloud Case). In June 2019, the Supreme Court ruled that the government had not raised an arguable point of law, the court of appeal ruling was upheld. The ruling from the original McCloud case impacts on local government pension schemes and their admitted bodies, including Scottish Canals. As a consequence, the original McCloud judgment gives rise to a past service cost and liability within the scope of IAS 19 as the original ruling effectively creates a new obligation. Scottish Canals IAS 19 actuarial valuation did not include provision for the impact of McCloud case. Consequently, there is an estimation difference within the accounts. Hymans Robertson has provided Scottish Canals with an estimate of the impact of incorporating the McCloud case into the IAS 19 provision. This has been estimated as £49,000. We are satisfied that while the exclusion of the McCloud case gives rise to an estimation difference this is not material to the financial statements. Looking forward, we recommend that Management engage with the SPF and actuaries during 2019/20 to ensure Scottish Canals maintain an accurate understanding of pension liabilities. **Action Plan Point 1**

New accounting standards

The 2018/19 financial statements reflect the adoption of two new International Financial Reporting Standards (IFRS): IFRS 9: Financial Instruments, and IFRS 15: Revenue From Contracts With Customers. While the introduction of IFRS 9 resulted in some minor disclosure changes to the accounts including financial instruments disclosure note. Management's assessment of these standards was that they did not have a material impact on the financial statements. We have reviewed management's assessment and through our knowledge and understanding of the clients financial transactions are satisfied this is appropriate.

Looking forward, IFRS 16: Leases, comes into effect from January 2019 and therefore will be applicable to Scottish Canals' 2019/20 financial statements (unless the Accounts Direction required adoption of the HM Treasury Financial Reporting Manual which will defer adoption for a further year). IFRS 16 sets out the principles for the recognition, measurement, presentation and disclosure of leases and replaces IAS 17 Leases. IFRS 16 requires all leases to be accounted for 'on balance sheet', a major departure from the requirements of IAS 17 in respect of operating leases. It introduces a single accounting model for all leases, similar to the treatment of a finance lease under IAS17, with the exception of low value assets and short term (<12 months) leases. Management has began assessing leases held and the potential impact on the financial statements next year.

Going concern

As auditors, we are required to "obtain sufficient appropriate audit evidence about the appropriateness of management's use of the going concern assumption in the preparation and presentation of the financial statements and to conclude whether there is a material uncertainty about the entity's ability to continue as a going concern" (ISA (UK) 570).

We have reviewed Management's assessment of the organisations ability to continue as a going concern. Scottish Canals have an agreed budget for 2019/20, including funding from the Scottish Government. Management forecast that they will continue to meet financial obligations as and when they fall due. We are satisfied that Management's conclusion that Scottish Canals represents a going concern is appropriate.

Fraud and irregularity and post balance sheet events

There are no provisions or uncertainties related to the accounts. In relation to the audit risk of fraud in respect of expenditure we tested Scottish Canals' cut-off arrangements in particular (timing) and identified no issues in accruals or prepayments which would indicate potential fraud. There are no post balance sheet events or legal uncertainties at year-end.

Accounting framework: Scottish Canals – Public Corporation

Scottish Canals is currently established as a Public Corporation. In line with the Accounting Direction, which recognises the public corporation status of Scottish Canals, its principle accounting framework is aligned with the Companies Act. As set out in the Scottish Government publication "Public Bodies in Scotland: guide", a definition of a public corporation is:

"Public corporations are industrial or commercial enterprises under Government control which recover more than 50% of their costs through fees and charges for services provided to customers. They employ their own staff, who are not civil servants, manage their own budgets and report to a Board whose members are appointed by Ministers. Bodies are normally established as public corporations if they operate in a commercial environment or work closely with private sector providers"

Currently circa 57% of Scottish Canals income comes from sources out with Scottish Government (if you exclude capital funding). However, not all income is generated from customers but comes from other sources such as other public sector grant funding). Increasingly, Scottish Canals are becoming increasingly reliant on additional capital funding from the Government to maintain the Canals.

The Office for National Statistics (ONS) determine a bodies national accounting classification based on whether an organisation is public or private and market or non-market in order to produce accurate national accounts. Scottish Government determine the organisational type (e.g. Executive Agency, NDPB, Public Corporation etc.) depending on the body's functions and its relationship with Scottish Ministers and/or the Scottish Parliament.

Currently ONS information implies that Scottish Canals should be an NDPB, but Scottish Government have classified it as a Public Corporation.

In practice both public corporations and NDPBS are similar, although the following apply in certain circumstances:

- It is appropriate for Ministers to set the strategic framework for the body (NDPB)
- The functions or services in question require specialist knowledge or expertise which civil servants would be unable to provide (NDPB and public corporations)
- There is need for a body to provide independent, expert advice to ministers (NDPB and public corporation)
- They do not employ Civil Servants (NDPB and public corporations)

However, for bodies that are classified as NDPBs they follow HM Treasury's Financial Reporting Manual (FRem) and currently Scottish Canals does not.

We recommend that Scottish Canals discuss their classification, and then future accounting requirements, during 2019/20 to ensure they remain correctly classified and where appropriate in line with ONS classifications. **Action Plan Point 2**

We also note per the guidance both options are independent of Scottish Government and employees are not Civil Servants. It is recognised that the Chief Executive seconded to Scottish Canals from the Scottish Prison Service until 2023 is a Civil Servant. Scottish Canals and the sponsor department should ensure, where appropriate, independent safeguards are established to ensure the independent relationship is maintained, and there is no perceived conflict or otherwise from the perspective of customers or stakeholders of Scottish Canals. **Action Plan Point 3**

Narrative elements of your annual accounts

In accordance with our responsibilities we have reviewed your narrative aspects of the Annual Accounts and Report. We have considered the consistency of this narrative with our understanding and the financial statements and have set out our observations below. We have also audited the required information in the remuneration report (marked audited) and have no matters we wish to bring to your attention.

Directors Report and strategic Report

The strategic report outlines performance analysis and highlights the key issues and risks facing Scottish Canals. Key performance indicators are set out, although these are driven by Scottish Government national outcomes and how Scottish Canals contribute to these rather than directly aligned to the Corporate Plan

All required disclosures included in line with accounting requirements Financial performance analysis included is in line with our understanding and work performed.

There are opportunities to enhance the Director's Report to provide a clearer understanding of the board's performance during the year in delivering strategic objectives.

Overall observations

Scottish Canals "front end" of the annual report and accounts have been prepared in accordance with the requirements of the Companies Act as well as Accounts Direction.

Management will continue to look to develop the annual reporting each year.

Annual Report and accounts

Remuneration and staff report

The information provided below in respect of Scottish Canals' Board members complies with the provision of section 412 of the Companies Act 2006, as required by the Scottish Ministers.

The disclosures in the Remuneration and Staff report are consistent with underlying payroll records.

The Interim Chief Executive is on secondment from Scottish Prison Services. As the secondment arrangement is through invoice the amount has been disclosed in the report as the amount paid for the secondment during the year in line with Companies Act 2006 requirements.

Governance statement

All key required elements included within the corporate governance statement.

We made recommendations to Management around enhancing the transparency in the governance statement around challenges and risks in governance arrangements through the turnover in Board members during the year. These have been incorporated into the updated draft report.

Financial management



Scottish Canals incurred a deficit before tax of £2.008 million (2018: Surplus £35,000). The outturn position included a loss on the revaluation of investment properties of £1.4 million.



During 2018/19, Scottish Canals had additions of £15.592 million (2017/18: £6.669 million). The investment is part of an ongoing investment in Scottish Canals infrastructure including ongoing works at Ardrishaig pier, Fort Augustus Loch gates and Kytra Lock gates. Certain capital expenditure was funded through a one off increase in capital grant in year.



Scottish Canals have recognised the need for effective management of cost base to align investment expenditure with revenue receipts. Given the financial pressures facing Scottish Canals, including rising cost pressures such as the required maintenance of the Canals infrastructure, and the level of uncertainty and volatility around some of the revenue streams, it is critical that Scottish Canals have close financial monitoring and oversight. Management and the Board should consider if quarterly non-executive oversight is sufficient given the financial challenges faced by Scottish Canals.

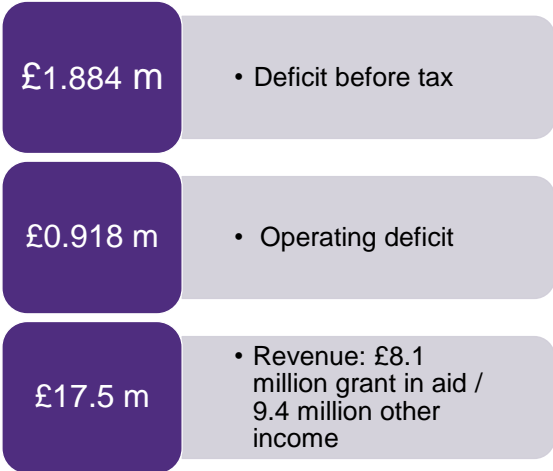
Financial management

Overall conclusion
Scottish Canals continues to operate under challenging financial environment. To meet the costs of continued investment and maintenance in the canals network, the organisation is dependent on revenue generated through commercial activities as well as on an increasing level Scottish government capital funding. Therefore is critical that Scottish Canals' financial planning and management arrangement remain robust.

Financial Performance

Scottish Canals incurred a deficit for the year before tax of £2.008 million (2018: Surplus £35,000). The outturn position included a loss on the revaluation of investment properties of £1.4 million. This was predominantly due to the downward valuation of land for development at Auchinstarry property (boathouse restaurant) due to the property valuation reflecting market conditions and viability with there no longer being a tenant on the property.

Scottish Canals operating deficit for 2018/19 was £0.918 million (2017/18: Deficit £0.614 million). The operating position reflects challenging financial pressures facing Scottish Canals. The original budget for 2018/19 forecast a surplus of £0.15 million. While revenue remained relatively stable at £17.5 million, operating costs were £18.335 million, an increased of £520,000 from the prior year. A key cost pressure for the Scottish Canals is payroll costs which increased by £0.6 million from 2017/18 and indicates the recurring cost base is growing faster than the revenue generation of the organisation.



Capital investment

During 2018/19, Scottish Canals had additions of £15.592 million (2017/18: £6.669 million). The investment is part of an ongoing investment in Scottish Canals infrastructure including ongoing works at Ardrishaig pier, Fort Augustus Loch gates and Kytra Lock gates. Capital Expenditure is funded primarily through Scottish Government Grant funding of £10.47million (2017/18: £4.295 million) and in third party funded works. The capital funding is dependent on the level of capital grants from the Scottish Government and other sources including City Deal for specific one-off projects. Without this one-off funding, Scottish Canals would have been unable to complete the level of repairs work during the year.



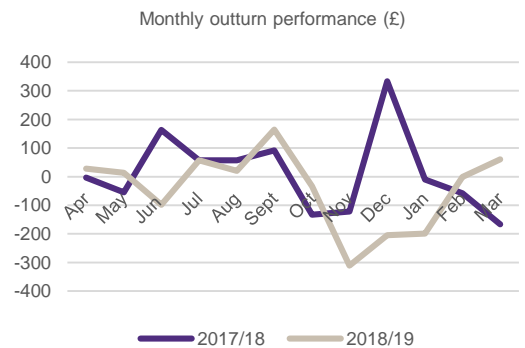
Millennium Link Trust

As set out in the related party note, Scottish Canals have a link to the Millennium Link Trust. A number of assets are held within this Trust, and are not assets of Scottish Canals for example the Falkirk Wheel. Under the arrangement, Scottish Canals lease property space from the Trust and Scottish Canals provide services on behalf of the Trust.

Financial management and capacity

Scottish Canals have an experienced qualified finance team. Financial performance is monitored by management and reported to the Board on a quarterly basis. The seasonal nature of Scottish Canals operating income and expenditure results in variability across the year. For 2018/19 the deficit was predominantly incurred through impairment on investments and costs pressures in the second half of the financial year which are challenging to establish mitigating actions.

Scottish Canals have recognised the need for effective management of cost base to align investment expenditure with revenue receipts. Within the 2019/20 Business Plan and financial plan, there is greater focus on cost base and planned phasing of expenditure. Given the financial pressures facing Scottish Canals, including rising cost pressures such as the required maintenance of the Canals infrastructure, and the level of uncertainty and volatility around some of the revenue streams, it is critical that Scottish Canals have close financial monitoring and oversight. Management and the Board should consider if quarterly non-executive oversight is sufficient given the financial challenges faced by Scottish Canals. **Action Plan Point 4**



Financial sustainability



Scottish Canals' Asset Management Strategy sets out how Scottish Canals will manage, care for, and prioritise works on the canals infrastructure to 2030. Management have estimated that it currently has a repair maintenance backlog of over £70 million. Current revenue, including Scottish Government grant funding and from Scottish Canals' commercial activity is insufficient to meet the level of investment required over the plan.



The 2019/20 budget has been developed through a zero based budget (bottom up) approach. The delivery of the financial plan will represent a critical challenge for Scottish Canals, including managing the cost base where there is uncertainty surrounding revenue streams. As Scottish Canals works towards the development of new Corporate Plan, a key element of this will be the planned and ongoing funding of strategic investments, including Dundas Hill. Currently, reporting of these projects is through quarterly business updates. Going forward, with the implementation of a new Corporate Plan, there is an opportunity to enhance the current reporting and monitoring of strategic investment activity.



Management are in the process of developing a new Corporate Strategy 2020-23. A critical area of focus over the term of the strategy will be how Scottish Canals aim to address the funding gap and backlog maintenance pressures in the Canals network and the strategic direction taken by Scottish Canals as it looks to manage these pressures. This is linked to a wider focus on what the vision is for Scottish Canals.

Within our audit plan we identified risk around financial sustainability at Scottish Canals. In accordance with the Code of Audit Practice, we have undertaken appropriate procedures to allow us to form a conclusion around the identified areas of risk and the organisation's financial sustainability. This includes review of corporate and financial strategies and plans as well as discussion with senior management.

Identified audit risk at planning

Scottish Canals have multiple income stream including Scottish Government funding and revenue generated through delivery of goods and services. The nature of the non-grant income is subject to risk of fluctuation through seasonal trend as well as canal usage. In addition, the core SG Grant funding may stay static or fall. Therefore the "cost" base of Scottish Canals needs to be agile and a medium term financial plan in place setting out various scenarios to ensure longer term financial viability. Furthermore, Management have forecast shortfalls in the finance required to continue to support the required investment in the canals infrastructure.

Scottish Canals continue to explore options for maximising the use of resources and operating as efficiently and effectively as possible.

Our Response:

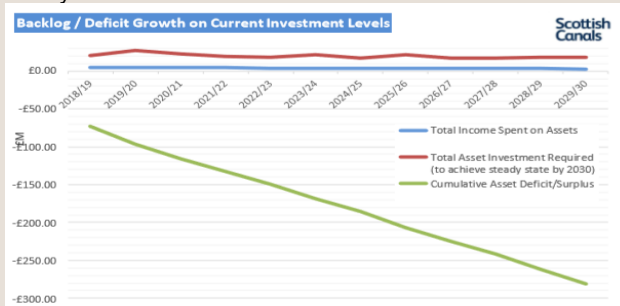
We will review the financial plans in place, including the scenarios set out, the governance of the plans and regular reporting on future financial scenarios. We will assess the extent to which savings are identified and delivered while ensuring that the organisation maintains the skills and experience within its workforce to deliver its corporate objectives.

Conclusion

The 2017-20 Corporate Plan outlines Scottish Canals' strategic priorities over the three year period of the plan. The Plan recognises the financial and operational challenges faced by Scottish Canals in undertaking its statutory obligations with regards the operating and maintenance of the waterways. These include both the immediate pressured of meeting the day to day operating and maintenance costs of the canals network, against a context of relatively static Government funding, as well as focusing on longer term strategic investment required to maintain the canals assets.

The 2019/20 Business Plan and supporting financial plan have been prepared in the context of operating within the financial resources available, through cost management and budgetary controls as well as focusing on revenue generating activities.

Over the medium to longer term, Scottish Canals' Asset Management Strategy sets out how the organisation will manage, care for, and prioritise works on the infrastructure of the nation's 250-year-old waterways to 2030. Management have estimated that it currently has an infrastructure repair, maintenance and investment backlog of over £70 million. Current revenue, including Scottish Government grant funding and from Scottish Canals' commercial activity is insufficient to meet the level of investment required over the plan. While, investment in the Canals network is prioritised based on risk and service usage, Management have estimated that the canals network is currently underfunded by between £6 million to £9 million each year.



Source: Scottish Canals Asset Management Plan 2018 - 2030

While Scottish Canals' Asset Management Plan aims to prioritise investment based on risk of asset failure and use of the asset, the Asset Management forecasts indicate that the current Canals infrastructure cannot be maintained in the current resource model.

As Scottish Canals is in the process of establishing a new 2020-23 Corporate Plan, a key challenge will be how the Board focus on key financial pressures and what the strategic direction of the organisation to address these and address these. The maintenance and investment of the canals network will be a key priority and are of focus for Scottish Canals over the coming years as it balances this with commercial activities.

Financial planning 2019/20

The financial plan, incorporated within the 2019/20 Business Plan, is developed using a zero-based budgeting approach to ensure that forecast income and expenditure is developed on key planned activity during the year. Financial forecasts are reviewed during the year to ensure these remain appropriate.

The financial plan for 2019/20 projects an operating surplus of £100,000. We consider the key assumptions below:

Key assumption	Budget £ million	Considered reasonable	Comment
Grant-in-aid income	8.5	✓	Budgeted Grant in Aid has been agreed to 2019/20 grant funding letter for the year.
Commercial Income	6.5	✓	Scottish Canals Commercial Income is subject to variability due to a range of factors impacting on service users / visitors and expenditure. However, the forecast revenue for 2019/20 is based on existing trends and considered reasonable.
Other income	12.3	Challenging	Note this includes grant funding from third parties to support capital investment as well as core revenue. Generating sufficient other revenue to support operating costs and investment in the infrastructure is critical for Scottish Canals.
Staff costs	(10.1)	✓	Scottish Canals is subject to the Scottish Government Pay Policy and the budget reflects the annual pay award for 2019/20 and forecast resource.
Third party costs & other costs	(17.1)	Challenging	Note this includes assumed capital expenditure funded through third party funding (see other income above). The expenditure includes assumed operating expenditure within the Core waterway as well as major infrastructure and regeneration activity as well as wider expenditure on commercial activities. Managing cost base remains a critical challenge for Scottish Canals. The level of operating costs can vary depending on customer pressures and expenditure on infrastructure. Management have recognised this challenge and have implemented cost controls around staff management and monitoring of expenditure.
Forecast surplus / (deficit)	0.100		

Financial plans are in place at Scottish Canals for 2019/20. There are a number of operational challenges where delivery of the financial plan will be challenging due to the nature of the costs incurred. Scottish Canals continue to monitor these forecasts to ensure that they continue to be appropriate.

As Scottish Canals works towards the development of new Corporate Plan, a key element of this will be the planned and ongoing funding of strategic investments, including Dundas Hill. From review of Board minutes and papers during 2018/19 we found that investment activity was reported sporadically throughout the year. There are opportunities to develop more strategic approach to investments and monitoring around the delivery and outcomes of these.

Governance and transparency



There is a lack of evidence to support the decision making in relation to the Chief Executive appointment during 2018/19 and up until the decision in June 2019 to enter into a secondment until 2023. We are unable to conclude on whether there was sufficient governance and transparency around the decision making due to a lack of documentation. We have seen no evidence that the Board in making decisions considered value for money of the arrangements, in particular the cost to Scottish Canals of the extension of the current secondment compared with the costs of recruiting and the potential Chief Executive candidate market. We also have seen no evidence that the Board fully considered all potential options available when making decisions, as there were no papers presented to the remuneration committee in June 2019 and no business case prepared.



With the level of new members there is an opportunity for Scottish Canals to self assess the existing governance arrangements in place against good practice and to consider whether the current arrangements are appropriate to provide the level of scrutiny and governance required, particularly during a period of financial and operational challenge. We would also recommend that Scottish Canals engage with the Scottish Government and Sponsoring Department to review the Board member terms to reduce the risk of such a large turnover in non-executives over a short period of time.

Scottish Canals is in a period of significant transition across the Board and senior management team. A robust recruitment process was put in place to support the appointment of two new Board members and the organisation has interim arrangements in place while it seeks the appointment of a new Chief Executive.

Identified audit risk at planning

Governance and transparency

Scottish Canals has in place well established systems of governance including clear roles and responsibilities and systems of internal control. The organisation continues to develop and enhance its financial and non-financial performance reports, including those available to the public.

During 2018/19 there have been significant changes across both executive and non-executive roles at the organisation, including the appointment of a new Chief Executive. Recognising the challenges facing Scottish Canals, it is important that there is strong and effective leadership from senior management and the Board.

Our Response:

We will continue to consider through discussions with management and review of minutes Scottish Canals' overarching governance arrangements and how Scottish Canals ensure that they are transparent and open to stakeholders including members of the public.

We will review the arrangements in place in ensuring new members embed including support and training to new members to support them in their role in providing effective leadership and governance of the organisation.

Conclusion

Strategic leadership and governance

The Scottish Canals Board are appointed on behalf of Scottish Ministers. The Board play a critical role in setting the organisation's strategic direction and providing leadership and oversight. During 2018/19, there has been significant changes across the Scottish Canals Board. Since March 2018, the Chair of Scottish Canals is the only remaining member of the six person Board (including Chief Executive). While we recognise that a number of the departures were due to the end of the individuals period of appointment, two Board members departed in advance of the end of their term. Five new appointments have been made by April 2019.

The level of transition across the Board can create risks to Scottish Canals including potential loss of corporate knowledge and understanding from committee members and potential strategic leadership and direction. It also creates uncertainty across staff and strategic partners around the organisations priorities and objectives. The transition of Board membership meant that there was inconsistent attendance across Board meetings. This can make having a consistent strategic approach difficult as well as oversight and scrutiny of performance challenging. For example we found the following:

- The 2019/20 Business Plan and key performance indicators for 2019/20 was approved in March 2019. This was approved by two non executives and the interim Chief Executive. While we recognise three members is quorum, we would have anticipated with the volume of new appointments that the Business Plan and indicators be subject to subsequent validation from new members at the subsequent meeting of the Board.
- With the transition of members of the Audit and Risk Committee, the scrutiny of the annual accounts, and assurance to the accountable officer and Board were all from committee members who have not been members for the full financial year, with the exception of one Board member.
- Scottish Canals currently operates with a Board membership of six, including the Chief Executive. The relatively small size of the Board means that the level of non-executive scrutiny and challenge can be limited to two or three individual in the event of vacancies at Board level or non-attendance at meetings. This was particularly challenging during the year.
- On two occasions during 2018/19 the Audit and Risk Committee was not quorate due to a lack of Board member attendance.

With the level of new members there is an opportunity for Scottish Canals to self assess the existing governance arrangements in place against good practice and to consider whether the current arrangements are appropriate to provide the level of scrutiny and governance required, particularly during a period of financial and operational challenge. We would also recommend that Scottish Canals review the Board member terms to reduce the risk of such a large turnover in non-executives over a short period of time. **Action Plan Point 5**

Chief Executive appointment (see detailed timeline in appendix 1)

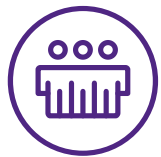
In May 2018, Scottish Canals, on the advice from Scottish Government, agreed the early release of the former Chief Executive following his resignation to become Chief Executive of Scottish Enterprise. The Board made an initial interim appointment to Chief Executive for a period of six months while a permanent replacement was sought. The interim appointment was through a secondment agreement with Scottish Prison Services.

Between May and August 2018, Scottish Canals undertook a recruitment process, with the support of an external recruitment agency. In September 2018, following short listing of candidates, interviews and Ministerial approval, Scottish Canals announced the appointment of a new Chief Executive, who had been the interim Chief Executive since June 2018. This announcement implied that the Chief Executive had been appointed on a permanent basis. There is no documentation retained to evidence the recruitment process that was followed, and the subsequent decisions taken by the panel, including the decision to accept a secondment. Following discussions we understood the Board fully endorsed a secondment, and that this was for ideally 5 years. There is nothing noted in the Board minutes that support this view and we have seen no reference to a preference of a secondment period of 5 years in any documentation we have been provided. We did receive subsequent email correspondence, between the Board Chair and Scottish Government sponsor department in September 2018 and October 2018 which implied the Board did not fully endorse a secondment, and a lack of awareness over the appointment decision being a secondment.

The original advert was amended by the interim Chief Executive in June 2018 to include the option of a long term secondment arrangement. From review of minutes and the Scottish Canals website there does not appear to be transparency that the appointment was an interim arrangement as the term “interim” was removed from title or references and we also noted that the risk around the recruitment of a permanent Chief Executive had been removed from the Corporate Risk register, which potentially indicates that nature of the appointment not being permanent was not as clear as it could have been.

We understand that a series of discussions took place between the Interim Chief Executive, their employer Scottish Prison Services (SPS) and the Scottish Government to reach a formal agreement on the secondment. In January 2019, the SPS agreed the secondment to December 2019. This was not formally agreed until 3 months after the public announcement of the appointment. We note the letter accompanying this secondment agreement explicitly states that there will be no further discussion or extension from the date set as end of December 2019.

In May 2019, the remuneration Committee agreed to commence the process of recruiting a permanent Chief executive and this was communicated across the organisation by the Board Chair. In early June (6th of June) the Interim Chief Executive received a personal letter from the Scottish Prison Services. This letter references discussions between the interim Chief Executive and their employer and the desire of the Interim Chief Executive to continue the secondment. This we understand resulted in discussions between the Interim Chief Executive and Board Chair. Although no evidence was formally retained of these discussions, or the subsequent discussions (email and calls) with the Board Members, based on certain emails we were able to obtain we understand the Board chair asked for approval to first re-look at the terms of the secondment including salary, and then approve the secondment until 2023. Following advice, the only change to the secondment terms was a 6 month notice period instead of 4 weeks. Approval was reached around the 11th of June and discussions took place with the Scottish Prison Service to allow a revised secondment to be signed late June. A remuneration committee was held on the 24th of June, in effect to ratify a decision already made. The minutes of this meeting could have been better as do not include any rationale or reference to the conversations that had taken place, in order to fully understand the decision making process. Again, like the previous decision there was no option appraisal or value for money assessment undertaken, to support the decision making process.



Evaluation of costs to Scottish Canals

In seeking to recruit a Chief Executive in June 2018 Scottish Canals got the recruitment business case signed off by the Scottish Government Sponsor team, as is required. This business case approved by Scottish Government aligned to Scottish Government pay policy, which assumes when replacing a member of the senior leadership team the salary should be circa 10% less than the current salary. The business case, taking into account base salary and benefits (including local government pension costs) was for a salary ranging from between £128,500 to £145,600.

Throughout 2018/19 and up to the decision taken in June 2019 no financial analysis had been undertaken to compare the costs to Scottish Canals of permanently recruiting a Chief Executive compared to the secondment option. An analysis was undertaken at our request and this highlighted the following differences between a full-time employee and the secondment:

- The Chief Executive can claim expenses to and from Scottish Canals Head Office as their base of employment is still shown as being Scottish Prison Services, in Edinburgh. There is a common figure quoted associated with this, as being a cost of £3,000 per annum but this value is not in the secondment agreement and there is no cap outlined.
- The Chief Executive is a member of the Civil Service Pension Scheme, which attracts higher employer contributions. Any increase in pension scheme contributions will need to be met in full by Scottish Canals, with no additional funding provided.
- The business case assumed annual benefits of £8,800 (reflecting car allowance and private healthcare) which are not being paid under a secondment.
- The secondment agreement does not mention salary increments. Therefore it is unclear whether salary increments would only apply based on Scottish Government civil servant pay arrangements or the Chief Executive is entitled to increments, aligned to Scottish Canals pay arrangements. If they apply per Scottish Government policy, then they cannot be controlled by Scottish Canals.

Current financial estimates show the secondment will cost Scottish Canals £167,178 in 2019/20 compared with the maximum signed off within the Business case of £145,600. As the arrangement is a secondment, Scottish Canals pay VAT on the invoices, and this is forecast to cost Canals £27,363 per annum and built into the cost. It is anticipated that over the period of the secondment the base salary may increase and/or civil service pension costs increase result in costs increasing per annum.

We would have expected a financial analysis to be undertaken and shared to inform the Board's decision making and how the Board evidence value for money in taking decisions. **Action Plan Point 6**

Fraud and Irregularity

Scottish Canals has arrangements in place to help prevent, detect and mitigate the risk of fraud or irregularity, including anti-bribery and whistleblowing policies. While we consider these to be reasonable, no arrangements can fully prevent against the risk of fraud, theft or irregularity. We are not aware of any material frauds at Scottish Canals during the course of the year and have confirmed this with management.

In 2018/19, Scottish Canals participated in the National Fraud Initiative (NFI) for the first time. The NFI is a counter fraud exercise co-ordinated by Audit Scotland working together with a range of Scottish public bodies, external auditors and the National Audit Office to identify fraud and error.

Management recognise that there are a number of areas where the arrangements for the NFI process could be enhanced, including incorporating the process into policies and procedures and formal documentation of the outcome of investigations. Management submitted the NFI data on time. However, as this was their first time participating in the NFI process they need to be better at using and closing matches on the NFI database and we noted at year end matches were still required to be investigated.

Action Plan Point 7

Board Governance arrangements

Scottish Canals Board consists of six members, including the Chief Executive. With the relatively small number of members this can cause challenges in terms of ensuring there is sufficient numbers of individuals to provide effective scrutiny and challenge. During 2018/19 we observed that while quorate, Board meetings took place with only two non-executive members present. Furthermore, given the diverse nature of Scottish Canals' activities, it is important to ensure that the Board has a range of skills and experience.

With the turnover of new Board members and the establishment of a new corporate plan which may establish a new strategic vision for the organisation, there is an opportunity for the Board to assess the adequacy and effectiveness of governance arrangements in place, including the size of the Board.

Value for money



Through the lack of transparency in the decision making process, we have been unable to evidence how Scottish Canals has considered value for money in the decision to enter into a secondment arrangement either in the initial appointment agreed in January 2019 or subsequent extension. Scottish Canals should demonstrate that decisions represent value for money and the efficient and effective use of public resources.



Scottish Canals continued to progress with the ongoing development of the Dundas Hill site project. Although no formal decision has been taken on the future development, management has estimated that the project will incur total costs of £15.508 million and a capped net profit to Scottish Canals of £3.86 million. It is important that the Board keep the investment under regular review to ensure that it continues to represent value for money.



As Scottish Canals matures as an organisation there is an opportunity to develop an overall framework for monitoring and reviewing strategic investments and their performance against planned outcomes. This will enable future investment decisions to not be taken in isolation and whether they are aligned to the wider investment priorities.

During our audit planning we identified a risk around the ongoing development at Dundas Hill. We conclude on our assessment of the risk below as well as our wider consideration of Scottish Canals' performance management arrangements.

Strategic decisions

Scottish Canals has a range of investments and commercial enterprises to contribute towards the investment in the Canals network. This includes commercial enterprises including those at Falkirk Wheel and Kelpies. In addition, Scottish Canals hold investment property of £16 million with the focus on generating revenue.

One key investment is the ongoing development of Dundas Hill. This is a significant project for Scottish Canals, which has associated reputational risks as well as opportunities for further income generating activities in the future. During 2019 Scottish Canals invested £4.6 million on the investment taking the total work in progress to £7.3 million as at 31 March 2019, predominantly funded through City Deal funding. During 2018/19 there was no formal decisions taken by Scottish Canals around the proposed development and sale of the site.

Scottish Canals is in the early process of developing a new Corporate Plan 2020-23, setting the strategic direction and priorities for the organisation over the coming years. Given the financial and operational pressures facing Scottish Canals, including the forecast level of underinvestment in the canals network, the Corporate Plan is critical in setting how the organisation will face these challenges in the coming years, a key element of this will be the planned and ongoing funding of strategic investments, including Dundas Hill and the wider North Glasgow developments.

Investment activity is reported to Scottish Canals' Board through quarterly business reports. As Scottish Canals matures as an organisation, and in the context of setting a new Corporate Plan, there is an opportunity to develop an overall framework for monitoring and reviewing strategic investments and their performance against planned outcomes. This will enable future investment decisions to not be taken in isolation and whether they are aligned to the wider investment priorities.



Action Plan Point 8

Performance Management

Scottish Canals operates a performance management system based on the Scottish Government's National Performance Framework as well as locally set strategic priorities.

The annual Business Plan outlines the planned activities and priorities in year to support the delivery of the strategic objectives. The monitoring of these allows for clear scrutiny of the delivery against strategic priorities.

During 2018/19 all KPIs were met throughout the year, demonstrating delivery of key aspects of the business plan.

We observed that performance against these KPIs was scrutinised by senior management and the Board and that the underlying performance of the organisation was transparent. The Board continues to look to develop its performance reporting arrangements and work is underway to incorporate reporting from the Asset Management Strategy into corporate performance reports.



Additional considerations of wider scope for 2018/19

In accordance with the Audit Scotland Planning Guidance, we consider the following areas of focus as part of our audit work:

EU Withdrawal

There are uncertainties surrounding the terms of the UK's withdrawal from the European Union in March 2019 and these are subject to ongoing negotiation between the UK government and EU. Whatever the outcome of these negotiations there is inevitably implications for devolved government in Scotland and for Scottish Canals

Conclusions

Scottish Canals has considered the impact of EU withdrawal on the organisation. Management has a good understanding of the potential risks around the potential impact of EU Withdrawal. Scottish Canals have followed EU Withdrawal guidance from the Scottish Government, including a detailed review of workforce and potential contractual implications. Wider consideration has also been given to potential impact on visitor numbers and subsequent commercial revenue. We consider Scottish Canals as being partly prepared for EU withdrawal.

While Management consider the immediate impact of EU withdrawal as being relatively low on the organisation, there is recognition that the longer term implications are less certain. In particular, potential impact on the value and revenue of investment properties or Scottish Government funding. These areas are kept under regular review through Management and Board horizon scanning.

Changing the landscape for public financial management

Recognising the changing landscape of Scottish public finances, including significant tax –raising powers as well responsibility for 11 social security benefits provides the Scottish Parliament with more policy choices. Subsequently, there is potentially greater volatility and complexity around Scottish budget and greater focus on the use of Scottish funds. This is likely to increase the scrutiny of public sector annual accounts and audit reports.

Conclusions

The focus on public entities performance reporting will be under increasing security, including that of the Board and how public funds are used. We have considered the extent to which the performance report provides an accessible account of the Scottish Canals overall performance and impact of its public spending and transparency of reporting.

Scottish Canals faces significant financial challenges over the coming years in ensuring that resources are prioritised appropriately. It is critical that there is a clear transparent approach to decision making around the use of Scottish Canals funding and demonstrating this through public performance reports.

Areas of wider scope focus 2018/19

Dependency on key suppliers

The collapse of Carillion and the subsequent impact across the public sector, has brought into focus the risk of key supplier failure and underperformance. We will consider the arrangements in place for identifying key supplier and risks, if any associated with these and how effectively these are being managed.

Conclusions

While Scottish Canals engage with a range of suppliers through the delivery of services or as part of capital investment projects. The majority of these contracts are through standard Scottish Government procurement call off arrangements or following procurement activities.

The nature of the contracts mean that in the event of supplier failure, while there may be some disruption or delay in service deliver of construction activity, alternative arrangements could be established. Suppliers are managed through service delivery and for larger capital projects overseen by Management.

Openness and transparency

There is an increased focus on how public money is used and what is achieved. This includes the extent to which the Scottish Canals keeps pace with public expectations and good practices in this area. Including: increased public availability of papers, insight into why any business is conducted in private and development of the form and content of annual reporting.

Conclusions

The Scottish Canals' Board meeting agendas and minutes are published on the Scottish Canals website. However, supporting papers, including committee minutes are not published. While we recognise that there may be reasons for not publishing supporting papers, including commercial sensitivity, we would encourage Scottish Canals to consider enhancing the level of information reported within the public. In addition, we found that while an action tracker is in place and a standing item on the Board agenda in following these up, the documented minutes do not clearly evidence if the action has been taken. Consequently, the transparency around decisions or actions taken by Management is lost. **Action Plan Point 9**

Appendices

Timeline of the Chief Executive appointment process

Audit adjustments

Action plan

Follow up of 2017/18 recommendations

Fees, independence and fraud arrangements

Communication of audit matters

Timeline of the Chief Executive appointment process

Date	Process
May 2018	The former Chief Executive leaves Scottish Canals in May 2018. An early leave date was agreed between Scottish Canals and the Scottish Government, in the interests of Scottish Enterprise, the new employer. The Scottish Canals' board agreed to work with the Scottish Government for the appointment of an interim Chief Executive until a recruitment exercise could be completed.
June 2018	An interim secondment arrangement was established to support Scottish Canals until a permanent Chief Executive could be appointed. The Interim Chief Executive came on secondment from the Scottish Prison Services (SPS) for a 6 month period to cover the recruitment timeline.
June 2018	Scottish Canals commissioned an external recruitment company to support them in the recruitment process. The timeline for recruitment was 13 July 2018, interviews with the recruitment company on 6 August 2018 and final panel interview week commencing 20 August (panel including Board Chair, a Board non-executive and in attendance a representative from the Sponsor Department and the recruitment company). The initial job advert was amended on 21 June 2018 to add in "Appointment on a seconded basis would be considered, with a minimum of a 3-year commitment". The request to amend the advert came from the Interim Chief Executive.
August 2018 and September 2018	Given a lack of documentation, based on our retrospective discussions, and later email trails there appeared to be a lack of clarity over the nature of the appointment in August 2018. Over this time period there was no remuneration committee and updates at Board meetings very limited. Nothing in the Board minutes from August 2018 until the actual secondment being signed (January 2019) references the discussions that took place, and the difficulties in agreeing the secondment terms.
September 2018	At the Scottish Canals' Board meeting of the 27 th September, the Chair congratulated the new Chief Executive on their appointment. There was no reference to this being an interim appointment or references captured in the minutes over the formal recruitment process undertaken.
September 2018	A formal announcement of the appointment of the Chief Executive with effect from October 2018 was sent by the Board Chair round the organisation. This announcement did not refer to the Interim/secondment nature of this appointment and all references going forward on the Scottish Canals website and publications refer to Chief Executive not Interim Chief Executive. At this point in time no formal secondment arrangement (beyond the initial interim appointment was in place).
Between September 2018 and December 2018	We understand a series of discussions took place between the Interim Chief Executive, their employer Scottish Prison Services (who hadn't been consulted on the proposed secondment term of three years and were unable to hold a vacancy for this period of time) and Scottish Government to reach a potential solution. In the meantime, the interim secondment continued, under the interim secondment.
Between September and December 2018	As discussions were ongoing, there were no formal updates made to the Board on the arrangement and no meetings of the Remuneration Committee, which is unusual.

Date	Process
October 2019	Email exchange between the Board Chair and Transport Scotland, as Sponsor Department. The emails include reference "a seconded CEO was never the preferred option of the Scottish Canals Board". A subsequent correspondence references an offer from Sponsor Department to support a further recruitment exercise if required.
January 2019	Decision reached that current Interim Chief Executive would continue to be seconded to Scottish Canals for a period no later than 31 December 2019. Current secondment terms and conditions continued unchanged. The Chair notified the Scottish Canals Board on 31 January 2019, that a recruitment process for a replacement for the Chief Executive, who was on secondment until 31 December 2019, would commence in the summer to ensure that the appointment would take effect from the conclusion of the secondment.
25 April 2019	The Scottish Canals' Board agreed on the 25 April that a draft recruitment plan for a replacement for the Interim Chief Executive, to be considered by the Remuneration Committee at its next meeting on 30 May 2019.
30 May 2019	Remuneration committee met on 30 May 2019. In attendance was the Interim Chief Executive, The Director of Finance and the Head of Human Resources and Organisational Development. As set out in the minute a decision was taken to recruit a new Chief Executive. There is nothing in the minute which considers exploring options around the current secondment arrangements, and that the decision to recruit is due to the secondment not being extended.
30 May 2019	An email was sent following the Board and Remuneration Committee by the Chair of the Board to the whole organisation announcing the decision to recruit a Chief Executive. The email states "...It will not be easy to find someone of that calibre, but the reputation of Scottish Canals is such that we expect considerable interest in the position and we are confident of a good number of applicants with the requisite skills and experience"
June 2019	On 6 th of June the Interim Chief Executive received a personal letter from the Chief Executive of Scottish Prison Service referencing the Interim Chief Executive's interest in extending the secondment further and outlining what this would mean. After this correspondence discussions took place between the Interim Chief Executive and the Board Chair, which were not recorded. The Board Chair emailed and called Board members to discuss this further and seek their approval. We have obtained some evidence of the email trail and this shows the Board Chair seeking approval, but there was no papers or rationale for the decision formally set out. The decision to agree for the secondment to continue was reached on 11 June 2019, and a new agreement signed late June 2019 once correspondence had taken place first over remuneration and whether conditions would stay same. All stayed same with the exception of notice period which was increased to 6 months.
24 June 2019	<p>The Remuneration Committee was advised that, in the process of arranging the open recruitment campaign for a new Chief Executive, the Scottish Prison Service had written to the current Interim Chief Executive confirming agreement to extend the secondment arrangements in place. The Committee agreed that <i>it was in the best interests of Scottish Canals to extend the current Chief Executive's secondment from SPS for four years until the end of May 2023</i>. The Committee noted that the Minister had approved the proposed secondment extension in principle. The Committee agreed that the recruitment campaign for a new Chief Executive should be halted and that discussions between Scottish Canals, SPS and the Scottish Government to formally the secondment agreement be expedited.</p> <p>There does not appear to have been formal consideration of the cost or benefits associated with such an arrangement, or the rationale articulated of why this was in the best interests of the organisation.</p>
26 June 2019 – 1 July 2019	Formal secondment agreement signed by Scottish Canals and Scottish Prison Service extending the Interim Chief Executive secondment to 2023.

Audit adjustments

Uncorrected and corrected misstatements

We are pleased to report that there were no uncorrected misstatements to the financial statements arising during our audit. Within the defined benefit pension scheme IAS 19 valuation we did identify an estimation difference. While we do not propose an audit adjustment as an actuarial calculation would be required we are satisfied this is unlikely to be material. The adjustments made are detailed below

Item	Dr (£'000)	(Cr) (£'000)	Description
	144		
1	Pensions – Service Cost		
			<i>Being adjustment to recognise defined benefit pension obligations from IAS 19 actuarial valuations</i>
	Pensions actuarial remeasurements	146	
	Pension liability	(290)	

Being adjustment to recognise defined benefit pension information provided by Hymans Robertson & KPMG

	Taxation charge for year	50	
2	Tax – deferred tax re-measurement	7	<i>Being adjustment for tax.</i>
	Deferred tax -asset	(57)	

Being adjustment to recognise tax information provided by KPMG

Estimation differences

The IAS 19 actuarial valuation incorporates a range of assumptions. The actuarial valuation as at 31 March 2019 excluded provision for the potential impact on Scottish Canal's pension liabilities following the McCloud case judgement. Hymans Robertson has estimated that the impact of the McCloud would be an increase in the IAS 19 defined benefit liabilities would (for Scottish Canals £49,000). In our experience the actual calculated impact is usually lower (between 0.7 – 1%) We are therefore satisfied that the exclusion of the McCloud case from the actuarial valuation would not result in a material misstatement within the financial statements.

Significant Disclosure recommendations

In accordance with auditing standards we are required to highlight significant disclosure misstatements to allow Audit and Risk Committees to evaluate the impact of these matters on the financial statements.

Disclosure omission	Detail	Adjusted
Updated disclosures around	We recommended disclosure adjustments to enhance disclosures around Board members remuneration including secondment arrangement with Scottish Prison Service	✓
Outturn performance information	Notes to the financial statements required updating including accounting policies with regards those accounts which were new in the current year and impact on the financial statements	✓
Lease disclosures	Adjustments to reflect future lease costs within the financial statements	✓
Pension fund disclosures	Disclosures required for the two defined benefit pension schemes in line with IAS 19 to reflect the actuarial valuation as at 31 March 2019.	✓

Action plan and recommendations

We have set out below, based on our audit work undertaken in 2018/19, those risks and recommendations we consider are of a higher risk to Scottish Canals that Management may wish to consider in the future.

Recommendation

Agreed management response

1. Local government defined benefit pension scheme

In December 2018, the Court of Appeal ruled that the transitional protection offered to some members of public sector pension schemes as part of reforms to those schemes amounts to unlawful discrimination (McCloud Case). In June 2019, the Supreme Court ruled that the government had not raised an arguable point of law, the court of appeal ruling was upheld. The ruling from the original McCloud case impacts on local government pension schemes and their admitted bodies, including Scottish Canals. As a consequence, the original McCloud judgment gives rise to a past service cost and liability within the scope of IAS 19 as the original ruling effectively creates a new obligation.

Scottish Canals IAS 19 actuarial valuation did not include provision for the impact of McCloud case. Consequently there is an estimation difference within the accounts. Based on the Government Actuarial Departments' assessment of the potential impact on the IAS 19 defined benefit liability at the balance sheet date, Management consider the maximum impact to be an increase in liabilities of £207,000 with the actual impact likely to be less. We are satisfied that while the exclusion of the McCloud case gives rise to an estimation difference this is not material to the financial statements. Looking forward, we recommend that Management engage with the SPF and actuaries during 2019/20 to ensure Scottish Canals maintain an accurate understanding of pension liabilities.

Management response: Accepted. Scottish Canals will continue to work with the actuaries as they determine the liabilities in relation the defined benefit pension scheme, taking fully in to account the implications of the McCloud case and through the next triennial revaluation of the Fund.

Action owner: Director of Finance

Timescale for implementation: June 2020 to ensure that the liabilities as at the next year end date of 31/03/20 are fully and appropriately recognised in the financial statements.

2. Financial governance

Scottish Canals financial statements are prepared in accordance with the Transport Act 1962 and directions issued thereunder by Scottish Ministers. The Accounts directions require Scottish Canals to prepare accounts in accordance with International Financial Reporting Standards (as adopted by the EU), and Companies Act 2006. This follows the framework of Public Corporation.

While Scottish Canals generate over 50% of their own revenue from commercial enterprises, the organisation remains dependent on Scottish Government revenue funding to meet operational costs. This is more reflective of central government body than a public corporation. The new corporate strategy expected to be finalised in 2020 will shape the future vision for Scottish Canals. With this it would be appropriate for Scottish Canals to liaise with Scottish Government to consider the suitability of the Accounts Direction and accounting framework that is adopted, including potential adoption of the HM Treasury FReM. We recommend that Scottish Canals discuss their classification, and then future accounting requirements, during 2019/20 to ensure they remain correctly classified and where appropriate in line with ONS classifications.

Management response: Accepted. Scottish Canals recognises the challenge to maximise its commercial and regeneration returns and the ongoing maintenance of the canal. This is part of the on-going dialogue with Scottish Government, via the Sponsor team regarding the original settlement agreed in 2012.

Action owner: Chief Executive

Timescale for implementation: December 2019

3. Independence

Per the guidance both Public Corporations and NDPBs are independent of Scottish Government and employees are not Civil Servants. It is recognised that the Chief Executive seconded to Scottish Canals from the Scottish Prison Service until 2023 is a Civil Servant. Scottish Canals and the sponsor department should ensure, where appropriate, independent safeguards are established to ensure the independent relationship is maintained, and there is no perceived conflict or otherwise from the perspective of customers or stakeholders of Scottish Canals.

Management response: *Scottish Canals are not aware of any guidance describing public corporations and NDPBs as being independent of Scottish Government. The board of Scottish Canals is appointed by and may be removed by Scottish Ministers. We will seek further guidance from Scottish Government on the implications of this recommendation.*

Action owner: Chair

Timescale for implementation: Immediately

Recommendation

Agreed management response

4. Financial management and capacity

Scottish Canals have recognised the need for effective management of cost base to align investment expenditure with revenue receipts. Within the 2019/20 Business Plan and financial plan, there is greater focus on cost base and planned phasing of expenditure.

Given the financial pressures facing Scottish Canals, including rising cost pressures such as the required maintenance of the Canals infrastructure, and the level of uncertainty and volatility around some of the revenue streams, it is critical that Scottish Canals have close financial monitoring and oversight. Management and the Board should consider if quarterly non-executive oversight is sufficient given the financial challenges faced by Scottish Canals.

Management response: Accepted. Scottish Canals recognises the need to address this, and notes the symmetry with the internal audit recommendations that report the need to standardise Board reports with relevant supporting information and suitable timescales for presentation. This will help to ensure that the Board packs when read alongside the minutes will provide a clear and robust audit trail for both internal and external audit.

Action owner: Chief Executive

Timescale for implementation: January 2020

5. Strategic leadership and governance

Scottish Canals have gone through a period of significant change across Board membership. The level of transition in membership created governance challenges during 2018/19, including level of oversight and scrutiny.

With the level of new members there is an opportunity for Scottish Canals to self assess the existing governance arrangements in place against good practice and to consider whether the current arrangements are appropriate to provide the level of scrutiny and governance required, particularly during a period of financial and operational challenge. We would also recommend that Scottish Canals, working with Scottish Government and Sponsor Department, review the Board member terms to reduce the risk of such a large turnover in non-executives over a short period of time.

Management response: Accepted. This will be considered as part of the on-going discussions with Scottish Government, via the Sponsor and in conjunction with the Internal audit recommendations.

Action owner: Chief Executive

Timescale for implementation: December 2020

6. Chief Executive recruitment

Scottish Canals went through a recruitment exercise during summer 2018 to recruit a new Chief Executive. This led to the appointment of an interim Chief Executive on secondment from Scottish Prison Service. On 24 June 2019, the Remuneration Committee approved the extension of the secondment by a further four years. While we recognise the initial decision to have interim arrangements in place to support the organisation, we have found a lack of transparency in the decision making process and governance around both the initial decision to appoint an interim Chief Executive for a period of 19 months, and subsequently extend the secondment by a further four years. In particular, as the arrangement is under secondment, Scottish Canals incur additional costs through both VAT and expenses on costs and we have been unable to evidence that this was factored into the decision making process by the Board prior to the appointment. Given the importance of the appointment to the organisation, it is critical that there is clear and transparent reporting of the recruitment and decision making processes.

Management response:

A new CEO has been appointed by Scottish Canals on a fixed term secondment basis following a robust recruitment exercise and on the basis of a unanimous recommendation from the recruitment panel.

The appointment has been agreed by Scottish Ministers on the basis of written submissions from civil servants. The Executive Management Team have developed Governance Standardisation Methodology which sets out a standard format for all future Board reports to ensure consistent and clear reporting.

No further action is considered necessary at this time.

Recommendation

Agreed management response

7. National Fraud Initiative

In 2018/19, Scottish Canals participated in the National Fraud Initiative (NFI) for the first time. The NFI is a counter fraud exercise co-ordinated by Audit Scotland working together with a range of Scottish public bodies, external auditors and the National Audit Office to identify fraud and error.

Management recognise that there are a number of areas where the arrangements for the NFI process could be enhanced, including incorporating the process into policies and procedures and formal documentation of the outcome of investigations. Overall we found Management has effective arrangements in place for the submission of data and investigation of potential matches. However, Management should ensure that the outcomes from investigations are clearly documented on the NFI database.

Management response: We will work to establish a new process and reporting mechanisms, in line with best practice recommendations from Audit Scotland, to ensure that we can fully comply with the requirements of NFI reporting.

Action owner: Director of Finance

Timescale for implementation: February 2020

8. Dundas Hill and wider investment strategy

Scottish Canals has a range of investments including the ongoing development of Dundas Hill. From review of Board minutes and papers during 2018/19 we found that investment activity was reported sporadically throughout the year. As Scottish Canals matures as an organisation there is an opportunity to develop an overall framework for monitoring and reviewing strategic investments and their performance against planned outcomes. This will enable future investment decisions to not be taken in isolation and whether they are aligned to the wider investment priorities.

It is important that Scottish Canals ensure the investment continues to represent value for money with a marketable asset. In addition, it is important that should the planned use of the site change, this may have a material impact on the accounting treatment for the investment. Given the value of the level of investment made, it is important that the level of works and investment activity is kept under regular review.

Management response:

We accept that reporting of investment activity has been sporadic, and we will put in place systematic regular reporting going forward as part of a wider overhaul of reporting to the board.

Action owner: Company Secretary & Director of Estates & Operations

Timescale: Immediate

We accept that the evolving nature of our investment funds means that we need to better align individual investment decisions with wider investment priorities, including the need to develop an overall framework for doing so. We will develop such a framework to distinguish clearly between investment of unrestricted investment capital for public value and investment of restricted capital to fulfil associated contractual liabilities (such as that derived from NGIWMS).

Action owner: Chief Executive & Director of Estates & Operations

Timescale: By March 2020

9. Transparency

The Scottish Canals' Board meeting agendas and minutes are published on the Scottish Canals website. However, supporting papers, including committee minutes are not published. While we recognise that there may be reasons for not publishing supporting papers, including commercial sensitivity, we would encourage Scottish Canals to consider enhancing the level of information reported within the public.

Management response: Accepted; Scottish Canals notes the symmetry in the recommendation with internal audit and have already progressed the improvement of enhancing information that is available and easily accessible in 18/19 and has established plans to continue to review and enhance this transparency in 19/20.

Action owner: Company Secretary
Timescale for implementation: March 2020

Follow up of 2017/18 recommendations

We set out below our follow up of our 2017/18 recommendations and this is reflected below for information.

Recommendation

Strategic leadership and governance

Scottish Canals is going through a significant period of change through the departure of the Chief Executive as well as the terms of appointment of a number of non-executive members coming to an end. The former Chief Executive played a critical role in setting and delivering the strategic vision of the organisation. In particular the promotion of commercial revenue generating activities. With the loss of a key senior leader, and in light of the significant challenges facing the organisation particularly around the medium to long term financial sustainability of the canals network, there is a significant risk that the organisation may lose its strategic focus to address these challenges. It is critical that with new Board members there is focus on strategic challenges facing the organisation to both support and challenge management on the delivery of these.

Initial management response

The immediate focus of the organisation is as articulated within the Corporate Plan and Business Plan.- Financial sustainability / Public value / empowered and motivated people. The on-boarding and induction process for new Board members will be comprehensive and will demonstrate clearly the aims and objectives of the corporate plan and business plan and will highlight the significant contribution that Scottish Canals makes to the Scottish Government's wider aims and objectives as articulated in the National Performance Framework.

Follow up

CLOSED

On Boarding process has been established for all new non-executive appointments during the year. Scottish Canals is in the process of developing the new Corporate Plan 2020-23. This will shape the strategic priorities for the organisation, reflecting those of the new board members. Note we have raised recommendations for Scottish Canals Board and Management to consider during the year as detailed above.

Fees, independence, fraud arrangements

External Audit Fee

Service	Fees £
External Auditor Remuneration	29,370
Pooled Costs	7,070
Contribution to Audit Scotland costs	1,760
Contribution to Performance Audit and Best Value	0
2018-19 Fee	38,200

The audit fee was calculated in accordance with guidance issued by Audit Scotland and agreed with Management.

The above fee has not changed from that proposed in our annual audit plan.

Fees for other services

Service	Fees £
European grant certification	2,000

EU Grant works relates to independent certification of grants. This work is not considered to represent a conflict of interest and has been subject to approval through Grant Thornton's ethics team and Audit Scotland.

Independence and ethics

We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention.

We have complied with the Auditing Practices Board's Ethical Standards and therefore we confirm that we are independent and are able to express an objective opinion on the financial statements.

We confirm that we have implemented policies and procedures to meet the requirements of the Auditing Practices Board's Ethical Standards.

We are required by auditing and ethical standards to communicate any relationships that may affect the independence and objectivity of the audit team.

We can confirm no independence concerns have been identified.

Fraud arrangements

In assessing our audit risks, the audit team was alert to the possibility of fraud at Scottish Canals.

As part of our audit work we are responsible for:

- identifying and assessing the risks of material misstatement of the financial statements due to fraud in particular in relation to management override of controls.
- Leading a discussion with those charged of governance (for Scottish Canals this is assumed to be the Audit and Risk Committee) on their view of fraud. We did this when presenting our audit plan and in the form of management and those charged with governance questionnaires.
- designing and implementing appropriate audit testing to gain assurance over our assessed risks of fraud
- responding appropriately to any fraud or suspected fraud identified during the audit. – None were identified in-year

As auditors we obtain reasonable but not absolute assurance the financial statements as a whole are free from material misstatement, whether due to fraud or error.

We will obtain annual representation from management regarding managements assessment of fraud risk, including internal controls, and any known or suspected fraud or misstatement.

It is **Scottish Canals'** responsibility to establish arrangements to prevent and detect fraud and other irregularity. This includes:

- developing, promoting and monitoring compliance with standing orders and financial instructions
- developing and implementing strategies to prevent and detect fraud and other irregularity
- receiving and investigating alleged breaches of proper standards of financial conduct or fraud and irregularity.

Throughout the audit we worked with Scottish Canals to review specific areas of fraud risk, including the operation of key financial controls.

We also examined certain policies in place, strategies, standing orders and financial instructions, as relevant to the fraud framework, to ensure that they provide a reasonable framework of internal control.

No suspected frauds or irregularities have been identified by Management and reported in-year.

Communication of audit matters

Our communication plan	Audit Plan	Audit Findings
Respective responsibilities of auditor and management/those charged with governance	•	
Overview of the planned scope and timing of the audit, including planning assessment of audit risks and wider scope risks	•	
Confirmation of independence and objectivity	•	•
We are independent of Scottish Canals and have not identified any conflicts of interest		
A statement that we have complied with relevant ethical requirements regarding independence. Relationships and other matters which might be thought to bear on independence. Details of non-audit work performed by Grant Thornton UK LLP and network firms, together with fees charged. Details of safeguards applied to threats to independence	•	•
We have not incurred any non-audit fees during the year and no threats to independence identified		
Significant matters in relation to going concern	•	•
No significant going concern matters identified		
Views about the qualitative aspects of Scottish Canals accounting and financial reporting practices, including accounting policies, accounting estimates and financial statement disclosures		•
Set out in the Financial statements Section		
Significant findings from the audit		•
No significant findings from our audit		
Significant matters and issues arising during the audit and written representations that have been sought		•
Letter of representation will be shared and signed by the Head of Legal Services on behalf of Scottish Canals when signing the financial statements.		
Significant difficulties encountered during the audit		•
No difficulties encountered		
Significant deficiencies in internal control identified during the audit		•
None identified		
Significant matters arising in connection with related parties		•
None identified		
Identification or suspicion of fraud involving management and/or which results in material misstatement of the financial statements		•
None identified. Nil fraud returns were submitted to Audit Scotland each quarter throughout 2018/19.		
Non-compliance with laws and regulations		•
None noted		
Unadjusted misstatements and material disclosure omissions		•
None noted. Minor disclosure amendments only and these were not material in nature		
Expected modifications to the auditor's report, or emphasis of matter		•
None, an unqualified opinion		

International Standards on Auditing (UK) (ISA) 260, as well as other ISAs, prescribe matters which we are required to communicate with those charged with governance, and which we set out in the table above.

We communicate any adverse or unexpected findings affecting the audit on a timely basis, either informally or via a report to Scottish Canals Management and the Audit and Risk Committee.

