

Scottish Canals Financial year ending 31 March 2021

External Audit Plan

Audit and Risk Committee

March 2021



**Your key Grant Thornton
team members are:**

Jo Brown

Audit Partner

T 0141 223 0848

E joanne.e.brown@uk.gt.com

Claire Connor

Manager

T 0141 223 0814

E claire.e.connor@uk.gt.com

Fraser Hoggan

Audit In-Charge

T 0141 223 0746

E fraser.w.hoggan@uk.gt.com

Contents

Section	Page
Plan overview	03
Introduction	04
Audit approach	05
Materiality	06
Significant audit risks	07
Wider scope risks identified in planning	11
Other matters	13
Audit timeline	16
Quality and adding value through the audit	17
Audit Fees	18
Independence	20
Appendices	
Responsibilities	22
Communication	23
Fraud responsibilities	24
Auditing Accounting Estimates and Related Disclosures (ISA 540 revised)	25

The contents of this report relate only to the matters which have come to our attention, which we believe need to be reported to you as part of our audit planning process. It is not a comprehensive record of all the relevant matters, which may be subject to change, and in particular we cannot be held responsible to you for reporting all of the risks which may affect the organisation or all weaknesses in your internal controls. This report has been prepared solely for your benefit and Audit Scotland (under the Audit Scotland Code of Practice 2016). We do not accept any responsibility for any loss occasioned to any third party acting, or refraining from acting on the basis of the content of this report, as this report was not prepared for, nor intended for, any other purpose.

Plan overview

The audit plan for the financial year ending 31 March 2021 sets out our risk based audit approach. This plan is reported to those charged with governance (Audit and Risk Committee on behalf of the Board). Planning is a continuous process and we will continue to review our risk assessment and planned approach throughout the year.

03

Wider Scope Audit

In accordance with the Code we have identified wider scope risks, at the planning stage and will conclude on these during the audit.

Risks have been identified in relation to the following areas:

- Financial sustainability; and
- Governance and transparency.

01

Materiality

We have calculated planning materiality using budgeted gross expenditure for 2020-21 resulting in the following:

- £320,000 planning materiality being approximately 1.7% of expenditure based on the 2020/21 budget. Performance materiality of £225,000 is based on 70% of planning materiality and our trivial reporting threshold is £16,000.
- Lower materiality of £5,000 will be used on the Remuneration and Staff Report.
- We will revisit our materiality throughout our audit including updating to reflect the unaudited financial statements.

04

Other audit matters

We summarise other audit matters for the Audit and Risk Committee's awareness. This includes:

- The revised ISA 540 standard relating to Accounting estimates and the additional considerations required at planning in relation to this standard. For Scottish Canals we anticipate this to relate to depreciation, valuation of property, plant and equipment, valuation of investment properties, valuation of investments, prepayments and accrued income (including unagreed rent), accruals, VAT liability and estimates in relation to defined benefit pension schemes.
- In accordance with the Code and planning guidance we also complete and submit a number of deliverables in year including sharing intelligence with Audit Scotland
- Consideration of going concern in accordance with Practice Note 10.

02

Financial statement audit risks

At planning, in accordance with the ISAs (UK) and FRC Practice Note 10 we have identified the following significant financial statement audit risks:

- Management override of controls (ISA UK 240);
- Risk of fraud in revenue recognition (cut-off);
- Risk of fraud in expenditure (cut-off) (FRC PN10);
- Valuation of property, plant and equipment (PPE) and investment properties (valuation);
- Defined benefit pension schemes (valuation); and
- Preparation of the Annual Report and Accounts in accordance with HM Treasury Financial Reporting Manual (FRM).

05

Our Audit Fee

Audit fees were shared by Audit Scotland with Scottish Canals in December 2020.

- Our fee agreed with the Chief Executive Officer is £54,660. This fee includes £7,130 of pooled costs and a contribution of £1,580 to Audit Scotland costs.
- We have increased our fee for 2020/21, as a one off increase, related to opening balances work on transition to NDPB.
- Audit fees are paid to Audit Scotland who in turn pay Grant Thornton.
- We reserve the right to review our fee during the audit should significant delays be encountered and/or new technical matters arise.

Introduction

Purpose

This document provides an overview of the planned scope and timing of the external audit of Scottish Canals for those charged with governance.

We are appointed by the Auditor General as the external auditors of Scottish Canals for the 6 year period (2016/17 until 2021/22).

Respective responsibilities

Audit Scotland has issued a document entitled Code of Audit Practice ('the Code') dated 2016 covering this audit appointment period. This summarises where the responsibilities of auditors begin and end and what is expected from the audited body. Our respective responsibilities, and that of Scottish Canals are summarised in Appendix 1 of this plan. We draw your attention to this and the Code.

Scope of our audit

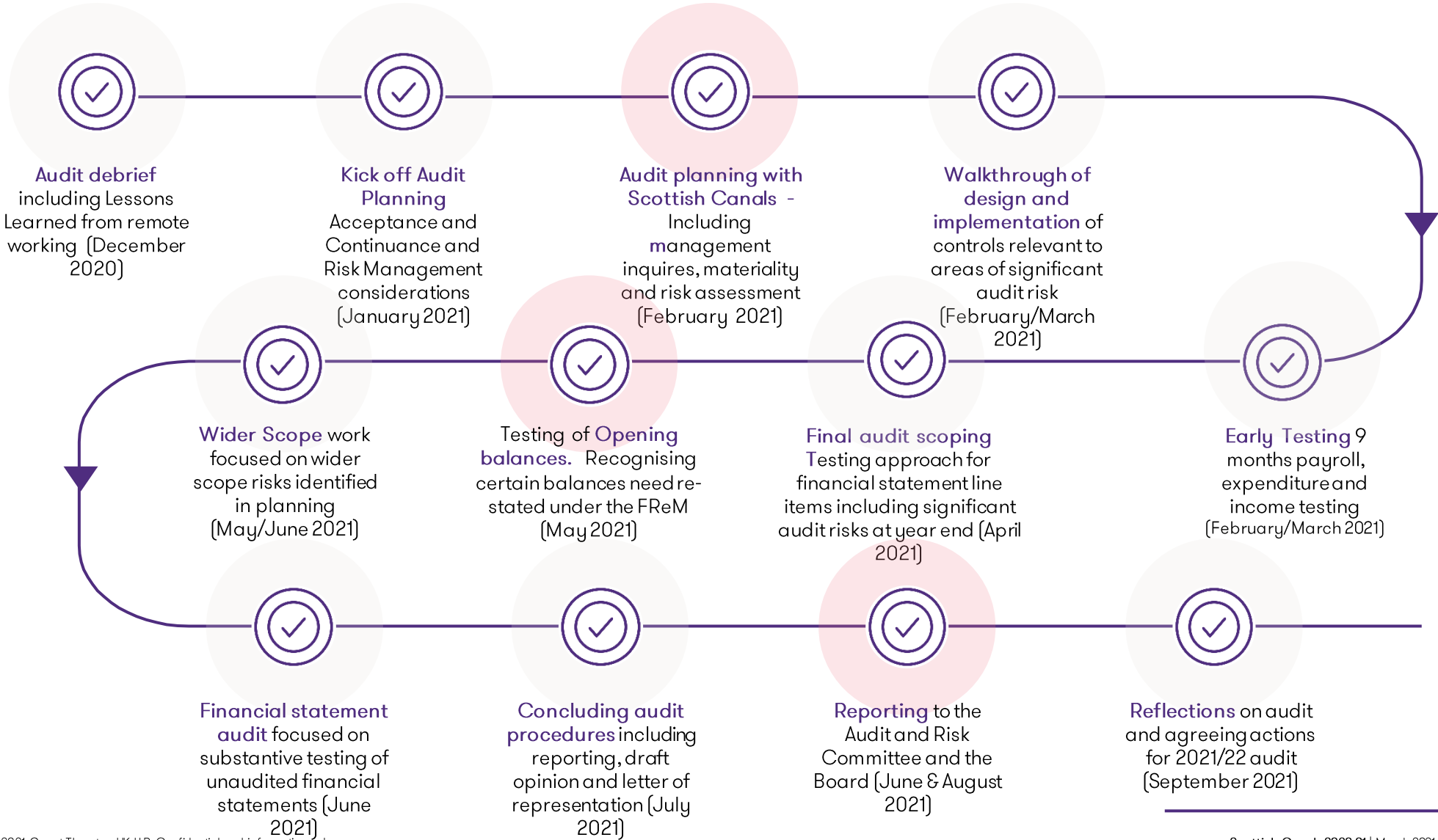
The scope of our audit is set in accordance with the Code and International Standards on Auditing (ISAs) (UK). We are responsible for forming and expressing an opinion on Scottish Canals' financial statements that have been prepared by management with the oversight of those charged with governance (the Audit and Risk Committee).

The audit of the financial statements does not relieve management or the Audit and Risk Committee of your responsibilities. It is the responsibility of Scottish Canals to ensure that proper arrangements are in place for the conduct of its business, and that public money is safeguarded and properly accounted for. We will consider how Scottish Canals is fulfilling these responsibilities.

Our audit approach is based on a thorough understanding of Scottish Canals and is risk based.

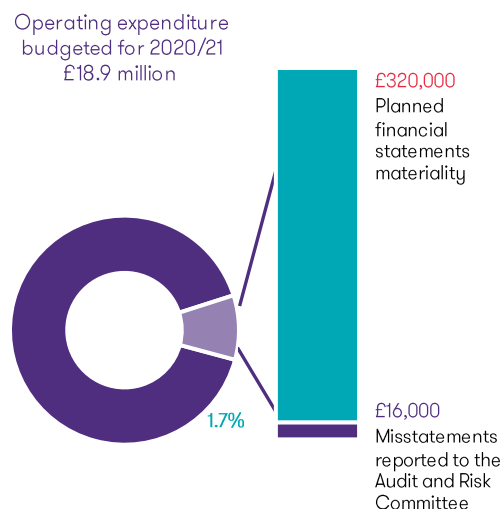


Audit approach



Materiality

Financial statement materiality is determined based on a proportion of the total expenditure. We have determined **planning materiality** to be £320,000, which equates to approximately 1.7% of operating expenditure budgeted for 2020/21.



Performance materiality represents the amount set for the financial statements as a whole to reduce the probability that the aggregate of uncorrected and undetected misstatements exceed materiality. We use this to determine our testing approach to the financial statements. We have set this at 70% of planning materiality (£225,000) which is a decrease on the prior year rate of 75%. This is based on our understanding of Scottish Canals, having no material uncorrected misstatements in the prior year but reflecting the perceived increased risk of material misstatement due to error within the financial statements as a result of COVID-19 and its impact on Scottish Canals, as well as being the first year in which Scottish Canals' financial statements will be prepared in line with the FReM (see page 15).

Our materiality benchmark of operating expenditure has changed from the prior year (revenue). With Scottish Canals having transitioned to being a Non-Departmental Public Body as of 1 April 2020 and now being required to report as per the Scottish Public Finance Manual (SPFM) and the HM Treasury's Government Financial Reporting Manual (FReM), we consider operating expenditure to be the key focus for the user of accounts.

Materiality reflects our professional judgement of the magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements.

On this basis we apply a separate **lower materiality level** (£5,000) to the Remuneration and Staff Report. This is set at a lower level in order to ensure greater precision in this area of the financial statements.

Under ISA 260 (UK) 'Communication with those charged with governance', we are required by auditing standards to report uncorrected omissions or misstatements other than those which are '**clearly trivial**' to those charged with governance. We have determined this threshold to be £16,000 which is less than the maximum threshold prescribed by Audit Scotland of £250,000.

We will update our materiality based on the unaudited 2020/21 financial statements when received in late April 2021. During the course of our audit engagement, we will continue to assess the appropriateness of our materiality.

Significant audit risks

Significant risks are defined by ISAs (UK) as risks that, in the judgement of the auditor, require special audit consideration. In identifying risks, audit teams consider the nature of the risk, the potential magnitude of misstatement, and its likelihood. Significant risks are those risks that have a higher risk of material misstatement.

Management Override of Controls (as required within Auditing Standards – ISA 240)

Our risk focuses on the areas of the financial statements where there is potential for management to use their judgement to influence the financial statements alongside the potential to override Scottish Canals' internal controls, related to individual transactions.

Our work focuses on critical estimates and judgements as set out within the financial statements, including accounting policies. In addition, we specifically consider cut-off (of expenditure and income) and the use of manual journals during the year and in creating the financial statements where controls may be overridden by management.

Risk of Fraud in Revenue (as required within Auditing Standards – ISA 240)

As set out in ISA 240 there is a presumed risk that revenue may be misstated due to improper recognition of revenue in all entities.

The risk of management manipulation and fraud is deemed to be low in relation to income received via grant-in-aid funding from the Scottish Government. While material we consider this funding to be well forecast and directly agreed to Scottish Government funding letter and draw down, reducing the opportunity for manipulation and the inherent risk of material misstatement in revenue recognition. As such, we rebut the risk of fraud in revenue in relation to grant-in-aid income.

Scottish Canals generates other revenue through a range of sources including the sale of goods (water, utility and retail sales) and rendering services. These represent material revenue streams. We therefore consider the risk of fraud in revenue recognition to be present in material revenue streams recognised within sale of goods and rendering of services. Our planned testing procedures include specific testing around income cut-off procedures and substantive testing over pre and post year end sale of goods and rendering services income balances.

Significant audit risks (continued)

Risk of Fraud in Expenditure (as recommended in FRC Practice Note 10 for Public Sector entities)

Scottish Canals' operating expenditure in the year is analysed across a number of categories including Major Infrastructure Works, Core Waterway and Corporate and Support Services. Operating expenditure includes both payroll and non-payroll costs. We consider payroll costs to be well forecast and are able to agree these costs to underlying payroll systems. As such we believe there is less opportunity for a material misstatement as the result of fraud to occur in this area.

We therefore focus our risk on non-payroll operating expenditure. Our testing will include a specific focus on year end cut-off arrangements, where it may be advantageous for management to show a more favourable financial position in the context of reporting to Scottish Government and the need to achieve financial targets set.

Valuation of property, plant and equipment and investment properties

In accordance with the HM Treasury's Government Financial Reporting Manual (FReM), subsequent to initial recognition, Scottish Canals is required to hold property, plant and equipment on a valuation basis. The exact valuation basis depends on the nature and use of the assets. Specialised land, buildings, equipment, installations and fittings are held at depreciated replacement costs, as a proxy for fair value. Non-specialised land and buildings, such as offices, are held at fair value. There are further modifications to values depending on the nature and use of assets to ensure asset values are approximately stated. As at 31 March 2020, Scottish Canals' PPE of £82.5 million included Land and Buildings of £54.3 million. In addition £23.9 million of investment property was also held at 31 March 2020. Given the value of PPE and investment property held by Scottish Canals, the level of complexity and judgement in the estimation valuations and this being the first year in which land and buildings will be recognised at fair value as a result of the transition to the FReM (previously recognised at depreciated historical cost under IFRS), there is an inherent risk of material misstatement in the valuation of land and buildings and investment property. The risk is less prevalent in non land and buildings assets as these are generally held at depreciated historic costs, as a proxy of fair value and therefore less likely to be misstated.

Significant audit risks (continued)

Defined benefit pension scheme (valuation)

Scottish Canals participates in two defined benefit pension schemes: the Waterways Pension Fund and the Strathclyde Pension Fund, a local government pension scheme. In accordance with IAS 19: Employee Benefits, Scottish Canals is required to recognise its share of both scheme's assets and liabilities in the Statement of Financial Position. As at 31 March 2020 Scottish Canals had pension fund liabilities of £689,000.

Scottish Canals obtain an annual IAS 19 actuarial valuation of Scottish Canals' net liabilities in both of these pension schemes. There are a number of assumptions contained within the valuations, including: discount rate; future return on scheme assets; mortality rates; and, future salary projections. Given the material value of the scheme liabilities and the level of estimation in the valuation, there is an inherent risk that the defined benefit pension schemes could be materially misstated within the financial statements.

Preparation of the Annual Report and Accounts in accordance with HM Treasury Financial Reporting Manual (FReM)

Scottish Canals' financial statements for the year ended 31 March 2020 were prepared in accordance with International Financial Reporting Standard as adopted by the European Union (EU). Under Scottish Canals new accounts direction issued by Scottish Ministers with effect from 1 April 2020, Scottish Canals are required to prepare accounts under the HM Treasury Financial Reporting Manual (FReM). The FReM provides guidance on the application of IFRS, adapted and interpreted for the public sector context. This can include requiring specific application of accounting standards and removing the option to adopt alternative accounting policies that may have been afforded to Scottish Canals' previously, under the standard alone. The adoption of the FReM is likely to have significant impact on Scottish Canals' current accounting policies, financial statements and balances. Scottish Canals should also consider investments held and conclude as to whether consolidated accounts should be prepared in accordance with the FReM. If consolidated accounts are prepared a group materiality will be calculated accordingly.

We have recognised a significant risk in regard to the first time adoption of the FReM, with specific focus in relation to the accounting disclosures required under the FReM and the perceived increased risk of error within the financial statements as a result of the preparation of accounts under a new accounting framework in 2020/21.

Significant audit risks (continued)

We have considered the overall **Impact of Covid-19 on the Financial Statements**, in particular whether there is a financial statement level significant risk, whether there is a significant risk relevant to specific balances or line items e.g. valuation of PPE and investment property, whether any risk factors should be considered when determining the audit strategy and designing audit tests and whether there are any audit risks due to the impact of the pandemic on the financial statements. We have concluded that there is no additional significant risk, in addition to those already captured, in relation to the impact of COVID-19 on the financial statement as a result of our consideration.

We will communicate significant findings on these areas as well as any other significant matters arising from the audit to you in our Annual Report to those Charged with Governance and the Auditor General in concluding our audit in August 2021.

Wider scope risks identified in planning

As set out in the Code we are required to consider significant wider scope risks that impact on Scottish Canals. Where we identify risks, similar to financial statement audit risks, we are required to devise a suitable programme of testing to allow us to conclude on Scottish Canals' arrangements. There are four wider scope dimensions we consider: Financial management, financial sustainability, governance and transparency and value for money. Wider scope risks are a matter of auditor judgement, and what we judge to be significant, considered on a risk basis. In addition to wider scope risks there may be other areas that Audit Scotland require us to consider. These requirements are set out in the planning guidance (2020/21). Where relevant we refer to them here, or within our wider audit plan.

Our previous Annual Reports have highlighted some of the challenges facing Scottish Canals including developing a financially sustainable operating model and Scottish Canals' need for appropriate resource with the financial skills and capability required to provide effective financial management and leadership. Our wider knowledge and experience of Scottish Canals has shaped our assessment of risk, as related to our 2020/21 external audit and we have identified the following wider scope risks:

Financial Sustainability

Consideration of the medium to long term financial sustainability of Scottish Canals. We will consider how Covid-19 has impacted on Scottish Canals' financial strategy and understand particular areas of cost pressures identified during the year.

We will focus on in-year financial performance and review the extent to which savings delivered during 2020/21 represent sustainable recurring savings. We will understand the impact of COVID-19 on Scottish Canals' ability to generate revenue in-year and any future year financial implications. We will review Scottish Canals' medium term financial plan.

Wider scope risks identified in planning (continued)

Governance and transparency

As set out in the planning guidance, we will consider how Scottish Canals has maintained **good governance** throughout the year, focused on any new governance arrangements introduced, the openness and transparency of decision making and how governance has evolved during the Covid-19 pandemic.

We will review the work done by Scottish Canals in order to strengthen the capacity and capability of the senior leadership team as well as the finance resource within the organisation. We will review the ways in which Scottish Canals has demonstrated effective financial leadership and the ability to meet financial challenges faced during the year.

Other matters

Auditor Responsibilities

We have a number of audit responsibilities as set out in the Code and planning guidance:

- We audit parts of your Remuneration and Staff Report in your Annual Report and check whether these sections of your Annual Report have been properly prepared (opinion)
- We read the sections of your Annual Report which are not subject to audit and check that they are consistent with the financial statements on which we give an opinion (opinion)
- We carry out work to satisfy ourselves that disclosures made in your Annual Governance Statement are in line with requirements set out in FReM (opinion)
- We consider our other duties under the Code and planning guidance (2020/21), as and when required, including:
 - Supporting Audit Scotland in Section 22 reporting.
 - Providing regular updates to Audit Scotland to share awareness of current issues.
 - Contributing to Technical Guidance Notes.
 - Notifying Audit Scotland of any cases of money laundering or fraud.
 - Review of Scottish Canals arrangements in respect of the National Fraud Initiative.

Internal control environment

Throughout our audit planning and fieldwork we will continue to develop our understanding of the overall control environment (design) as related to the financial statements. In particular we will:

- Consider procedures and controls around related parties, journal entries and other key entity level controls.
- Perform walkthrough procedures on key controls around identified risk areas including material sources of income, non-payroll expenditure, journal entries and material areas of management estimate and judgement
- Our focus is design and implementation of controls only. We do not place reliance on controls when it comes to our year end financial statement audit work.

Other material balances and transactions

Under International Standards on Auditing, "irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each material class of transactions, account balance and disclosure". All other material balances and transaction streams will therefore be audited. However, the procedures will not be as extensive as the procedures adopted for the significant risks identified in this report.

Other matters (continued)

Going concern assessment

As auditors, we are required to obtain sufficient appropriate audit evidence regarding, and conclude on:

- whether a material uncertainty related to going concern exists; and
- the appropriateness of management's use of the going concern basis of accounting in the preparation of the financial statements.

The Public Audit Forum has been designated by the Financial Reporting Council as a "SORP-making body" for the purposes of maintaining and updating Practice Note 10: Audit of financial statements and regularity of public sector bodies in the United Kingdom (PN 10). It is intended that auditors of public sector bodies read PN 10 in conjunction with (ISAs) (UK).

PN 10 has recently been updated to take account of revisions to ISAs (UK), including ISA (UK) 570 on going concern. The revisions to PN 10 in respect of going concern are important.

In particular, PN 10 allows auditors to apply a 'continued provision of service approach' to auditing going concern, where appropriate. In considering going concern we will refer to Audit Scotland's Going Concern publication (December 2020).

Within our wider scope work we will conclude on Scottish Canals' arrangements to ensure financial sustainability.

Accounting estimates

Under ISA (UK) 540 auditors are required to understand and assess an entity's internal controls over accounting estimates, including:

- The nature and extent of oversight and governance over management's financial reporting process relevant to accounting estimates;
- How management identifies the need for and applies specialised skills or knowledge;
- How the entity's risk management process identifies and addresses risks relating to accounting estimates;
- The entity's information system;
- The entity's control activities in relation to accounting estimates; and
- How management reviews the outcomes of previous accounting estimates.

To ensure compliance with this revised auditing standard, we will be requesting further information from management and those charged with governance during our audit. Based on our knowledge of Scottish Canals we have identified the following material estimates for which this is likely to apply; depreciation, valuation of property, plant and equipment, valuation of investment properties, valuation of investments, prepayments and accrued income (including unagreed rent), accruals, VAT liability and estimates in relation to defined benefit pension schemes.

Further detail is set out in Appendix 4.

Other matters (continued)

VAT liability

Scottish Canals historically recognised all of the supplies of goods and services as being linked to business activity and therefore 100% recoverable in input tax. In 2018 Scottish Canals had initial discussions with HMRC around the potential that some of the organisation's activities may not qualify as business activity. Scottish Canals VAT advisers provided a formal evaluation and response to HMRC. In February 2020 Scottish Canals received notice from HMRC that they had considered existing arrangements and had concluded that these services would be deemed as non-business and therefore irrecoverable from a VAT position. HMRC provided a summary assessment of the total VAT due from Scottish Canals, being those sums previously claimed amounting to £6.7 million dating back to February 2016. With interest from the date of notice the total amount payable as at 31 March 2020 was £7.1 million. Scottish Canals therefore recognised a VAT liability of £7.1 million in their financial statements as at 31 March 2020, representing the most accurate estimate of amount payable to HMRC.

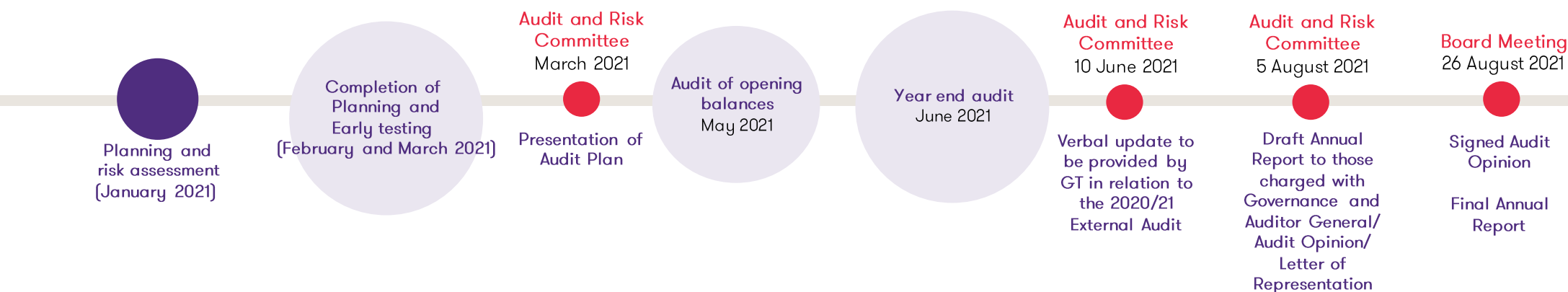
Scottish Canals have challenged HMRC's assessment and have continued to hold discussions with HMRC, the Scottish Government and their VAT advisers during 2020 in relation to this matter. We will review the latest related correspondence received as part of our year end audit procedures to gain assurance over the accuracy and completeness of the liability recorded at 31 March 2021 in relation to amounts due to HMRC.

New accounting framework – transition to the FReM as a Non-Departmental Public Body (NDPB)

On 1 April 2020 the organisation transitioned to a NDPB and from the accounting period beginning 1 April 2020 Scottish Canals is therefore required to report as per the Scottish Public Finance Manual (SPFM) and the HM Treasury's Government Financial Reporting Manual (FReM). This will result in significant changes in the accounting treatment for a number of balances and transactions as well as disclosure requirements in Scottish Canals' Annual Report and Accounts for the year ended 31 March 2021. In particular, as described on page 8 above, the FReM requires land and buildings to be held at current value which is a change from depreciated historical costs, the way they were previously valued under International Financial Reporting Standard as adopted by the European Union (EU). Similarly government funding is recognised as a resource limit to fund net operating expenditure under the FReM, rather than as income under IFRS.

This will have implications on Scottish Canals' financial reporting arrangements in 2020/21. In preparing accounts in accordance with the FReM for 2020/21, there will need to be a restatement of opening balances with comparators (as at 1 April 2019) as well as restating transactions and balances from 2019/20 to follow the requirements of the FReM.

Audit timeline



Client responsibilities

Where clients do not deliver to the timetable agreed, we need to ensure that this does not impact on audit quality or absorb a disproportionate amount of time, thereby disadvantaging other clients. Where additional resources are needed to complete the audit due to a client not meeting their obligations we are not able to guarantee the delivery of the audit to the agreed timescales. In addition, delayed audits will incur additional audit fees.

Our requirements

To minimise the risk of a delayed audit, you need to ensure that you:

- produce draft financial statements of good quality by the deadline you have agreed with us, including all notes, the Annual Report and the Annual Governance Statement;
- ensure that good quality working papers are available at the start of the audit, in accordance with the working paper requirements schedule that we have shared with you;
- ensure that the agreed data reports are available to us at the start of the audit and are reconciled to the values in the accounts, in order to facilitate our selection of samples for testing;
- ensure that all appropriate staff are available (or as otherwise agreed) over the planned period of the audit; and
- respond promptly and adequately to audit queries.

Quality and adding value through the audit

Our overall approach for the audit is clear and upfront communication, founded on our public sector credentials and a methodology to ensure delivery of a quality audit.

The diagram opposite summarises our key approach to adding value to you throughout our audit.

Our methodology is risk based. We comply with Auditing standards and as a Firm we are regulated by the FRC. We take findings on audit quality seriously and continue to invest as a Firm through our audit investment plan. The audit investment plan is supported by a specific national Public Sector audit plan.

We comply with Audit Scotland's quality arrangements including submitting an annual quality report over our Audit Scotland portfolio. As part of Audit Scotland's quality arrangements, ICAS review our work on a rotational basis. Audit Scotland's quality report can be found at www.audit-scotland.gov.uk

Our wider quality arrangements are set out in our annual transparency reports which are available on our website (www.grantthornton.co.uk).

Project management

- Use of Inflo to track progress and deliverables throughout the audit
- Clear roles and ownership of responsibilities within our team
- Clarity over expectations and timetable
- Track record delivering public sector audits on behalf of Audit Scotland

Clear reporting

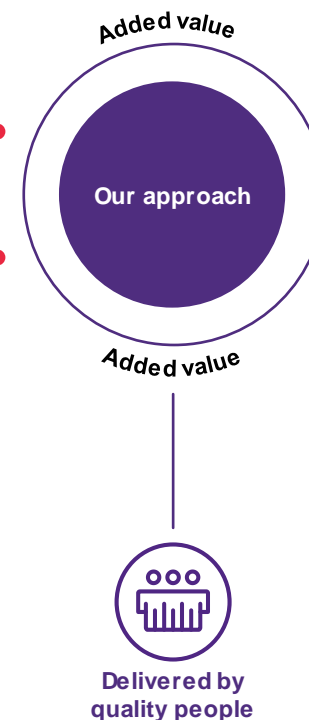
- Clear audit outputs at planning and within our final Annual Report
- Practical, risk based, recommendations for you to take forward
- Our judgements and conclusions set out transparently and in clear language
- Senior presence at Audit and Risk Committee to present our findings and support wider dialogue

Pragmatism and early attention of issues

- Accessible and proactive engagement team
- Working with you to reach the right solution – flexing the workplan, recognising Covid-19 restrictions
- Audit partner takes ultimate decision on technical matters, consulting with our technical experts

Public sector understanding

- Using our public sector insight to inform our audit and identify improvements you could make
- Regular meetings throughout the year sharing our observations and wider sector knowledge
- Wider scope conclusions to support you in considering key risks and the improvement actions to take



Audit Fees

Across all sectors and firms, the FRC has set out its expectation of improved financial reporting from organisations and the need for auditors to demonstrate increased scepticism and challenge and to undertake additional and more robust testing. This includes the revised ISA (UK) 540 (revised): Auditing Accounting Estimates and Related Disclosures. As a firm, we are absolutely committed to meeting the expectations of the FRC over audit quality and public sector financial reporting. This includes, for Audit Scotland contracts, meeting the expectations of the Audit Scotland Quality Team and the ICAS quality framework.

To meet the standards set we have engaged an auditor expert to enhance professional scepticism and assurance over the significant audit risk identified for valuations. This has been reflected as an increase above the baseline fee as not included in Audit Scotland fee assumptions, as has additional work over ISA 540. Our fee as set out has been agreed with the Chief Executive Officer.

Relevant professional standards

Audit Scotland set the baseline audit fee. We can increase the fee, from the baseline, for the inclusion of additional risks, new technical matters or specific client matters identified. We are required to consider all relevant professional standards, including paragraphs 4.1 and 4.2 of the FRC's [Ethical Standard \(revised 2019\)](#) which state that the Engagement Lead must set a fee sufficient to enable the resourcing of the audit with partners and staff with appropriate time and skill to deliver an audit to the required professional and Ethical standards. We believe the revisions to the baseline fee allow us to meet the required standard.

Additional external audit fee, above baseline

The baseline fee has been amended as set out below:

Additional fee requirements for 2020/21 audit	Fees £
Revisions to ISA 540 and additional work required by Auditors at planning and year end of judgements and significant estimates. This will be a 2020/21 additional cost only.	1,500
Property, plant and equipment and investment property valuations including the need for an auditors expert (valuations) and increased audit work over valuation. We are proposing to pass on 25% of the increased costs to you, with GT meeting the remaining 75% cost. (Note 1)	2,000
Review of dredging and technical accounting.	1,500
Testing of opening balances. Recognising certain balances need re-stated under the FReM compared with public corporation status. Deemed a one-off cost. (Note 2)	10,000
Additional fee above baseline	15,000

Note 1: At this stage there are some unknowns on property valuation. Should the costs be lower than forecast we will not pass this additional cost on to Scottish Canals.

Note 2: The opening balances work is an estimate and we can only determine that on receipt of the opening balances and supporting working papers. An element of opening balances will consist of procedures in relation to PPE and investment property valuations and certain accounting estimates and judgements, therefore this fee has currently been reduced to reflect that these fees have already been considered separately above.

Audit Fees (Continued)

Audit fees for 2020/21

Set out below is the agreed fee which reflects the increase to the baseline fee as outlined on the previous page.

Service	Fees £
External Auditor Remuneration	45,950
Pooled Costs	7,130
Contribution to Audit Scotland costs	1,580
Contribution to Performance Audit and Best Value	-
2020/21 Fee	54,660

Additional Fees (Non-Audit Services)

Service	Fees £
At planning stage we confirm there are no non-audit fees.	Nil
We undertake individual grant audit inspections for EU Grant funding for Scottish Canals. The total number of claims during 2020/21 have to be confirmed but will be no more than a maximum of 6.	£1,000 per claim

Fee assumptions

In setting the fee for 2020/21 we have assumed that Scottish Canals will:

- prepare a good quality set of accounts, supported by comprehensive and well-presented working papers which are ready at the start of the audit
- provide appropriate analysis, support and evidence to support all critical judgements and significant judgements made in preparing the financial statements
- provide early notice of proposed complex or unusual transactions which could have a material impact on the financial statements.

Independence

Auditor independence

Ethical Standards and ISA (UK) 260 require us to give you timely disclosure of all significant facts and matters that may bear upon the integrity, objectivity and independence of the firm or covered persons relating to our independence.

We encourage you to contact us to discuss these or any other independence issues with us.

We will also discuss with you if we make additional significant judgements surrounding independence matters.

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 Financial Reporting Council's Ethical Standard (Revised 2019) and we as a firm, and each covered person, 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 Ethical Standard.

Our team complete annual fit and proper declarations including independence confirmations on a client by client basis as well as completing timesheets. The work of our Ethics team is overseen by the Ethics partner and all staff undergo ethics training in year.



Appendices

Appendix 1 - Responsibilities

The Code sets out auditor responsibilities and responsibilities of the audited body. Key responsibilities are summarised below. Please refer to the Code for further detail.

Scottish Canals

Responsibilities include:

- Preparing financial statements that give a true and fair view;
- Maintaining accounting records;
- Establishing and maintaining systems of internal control;
- Effective internal controls including controls to achieve objectives and secure value for money;
- Establish arrangements for proper conduct of affairs including legality of transactions;
- Arrangements for prevention and detection of fraud, error, irregularity, bribery and corruption; and
- Appropriate corporate governance arrangements and arrangements to monitor the effectiveness of governance.

External Audit

Responsibilities include:

- Comply with professional engagement and ethical standards;
- Provide an ISA compliant audit and opinion on the financial statements including regularity of transactions;
- Demonstrate compliance with the wider scope public audit as detailed in the Code and applicable guidance;
- Liaise with and notify Audit Scotland when circumstances indicate a statutory report may be required. This includes sharing awareness of current and/or sector issues;
- Notify Audit Scotland of any known or suspected frauds greater than £5,000; and
- Contribute to relevant performance studies (as set out in the planning guidance for the year).



Appendix 2 - Communication

ISA (UK) 260 as well as other ISAs set out prescribed matters which we are required to report to those charged with governance (we assume this to be the Audit and Risk Committee on behalf of the Board). Our reporting responsibilities are set out below. We communicate all matters affecting the audit on a timely basis, to management and/or the Audit and Risk Committee.

	Audit Plan	Annual Report (considered our ISA 260 Report)
Our communication plan		
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	•	•
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	•	•
Significant matters in relation to going concern	•	•
Views about the qualitative aspects of Scottish Canals' accounting and financial reporting practices, including accounting policies, accounting estimates and financial statement disclosures		•
Significant findings from the audit		•
Significant matters and issues arising during the audit and written representations that have been sought		•
Significant difficulties encountered during the audit		•
Significant deficiencies in internal control identified during the audit		•
Significant matters arising in connection with related parties		•
Identification or suspicion of fraud involving management and/or which results in material misstatement of the financial statements		•
Non-compliance with laws and regulations		•
Unadjusted misstatements and material disclosure omissions		•
Expected modifications to the auditor's report or emphasis of matter		•

Appendix 3 - Fraud responsibilities

The term fraud refers to intentional acts of one or more individuals amongst management, those charged with governance, employees or third parties involving the use of deception that result in a material misstatement of the financial statements. In assessing risks, the audit team is 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. Typically we do 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; and
- responding appropriately to any fraud or suspected fraud identified during the audit.

As auditors we obtain reasonable 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. We also make inquires of internal audit around internal control, fraud risk and any known or suspected frauds in year.

Anti-Money Laundering Arrangements

As required under the Money Laundering, Terrorist Financing and Transfer of Funds Regulations 2017 there is an obligation on the Auditor General (as set out in the planning guidance) to inform the National Crime Agency if he knows or suspects that any person has engaged in money laundering or terrorist financing. Should we be informed of any instances of money laundering at Scottish Canals we will report to the Auditor General as required by Audit Scotland.

The primary responsibility for the prevention and detection of fraud rests with management and those charged with governance including establishing and maintaining internal controls over the reliability of financial reporting effectiveness and efficiency of operations and compliance with applicable laws and regulations.

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 work with Scottish Canals to review specific areas of fraud risk, including the operation of key financial controls. We also examine the policies in place, strategies, standing orders and financial instructions to ensure that they provide a strong framework of internal control.

In addition, as set out in the Audit Scotland Code of Audit Practice we have a role in reviewing Scottish Canals' arrangements in response to the National Fraud Initiative.

All suspected frauds and/or irregularities over £5,000 are reported to Audit Scotland by us as your auditors on a quarterly basis.

Appendix 4 - Auditing Accounting Estimates and Related Disclosures (ISA 540 revised)

Introduction

Under ISA (UK) 540 (Revised December 2018) auditors are required to understand and assess an entity's internal controls over accounting estimates, including:

- The nature and extent of oversight and governance over management's financial reporting process relevant to accounting estimates;
- How management identifies the need for and applies specialised skills or knowledge related to accounting estimates;
- How the entity's risk management process identifies and addresses risks relating to accounting estimates;
- The entity's information system as it relates to accounting estimates;
- The entity's control activities in relation to accounting estimates; and
- How management reviews the outcomes of previous accounting estimates.

As part of this process auditors also need to obtain an understanding of the role of those charged with governance, which is particularly important where the estimates have high estimation uncertainty, or require significant judgement.

Specifically do **Audit and Risk Committee** members:

- Understand the characteristics of the methods and models used to make the accounting estimates and the risks related to them;
- Oversee management's process for making accounting estimates, including the use of models, and the monitoring activities undertaken by management; and
- Evaluate how management made the accounting estimates?

Additional information that will be required for our March 2021 audits

To ensure our compliance with this revised auditing standard, we will be requesting further information from management and those charged with governance during our audit for the year ended 31 March 2021. Based on our knowledge of Scottish Canals we have identified the following material accounting estimates for which this is likely to apply:

- Depreciation;
- Valuation of property, plant and equipment;
- Valuation of investment properties;
- Valuation of investments;
- Prepayments and accrued income (including unagreed rent);
- Accruals;
- VAT liability; and
- Estimates in relation to defined benefit pension schemes.

Scottish Canals' Information systems

In respect of Scottish Canals' information systems we are required to consider how management identifies the methods, assumptions and source data used for each material accounting estimate and the need for any changes to these. This includes how management selects, or designs, the methods, assumptions and data to be used and applies the methods used in the valuations.

When the models used include increased complexity or subjectivity, as is the case for many valuation models, auditors need to understand and assess the controls in place over the models and the data included therein. Where adequate controls are not in place we may need to report this as a significant control deficiency and this could affect the amount of detailed substantive testing required during the audit.

Appendix 4 - Auditing Accounting Estimates and Related Disclosures (continued)

If management has changed the method for making an accounting estimate we will need to fully understand management's rationale for this change. Any unexpected changes are likely to raise the audit risk profile of this accounting estimate and may result in the need for additional audit procedures.

Estimation uncertainty

Under ISA (UK) 540 we are required to consider the following:

- How management understands the degree of estimation uncertainty related to each accounting estimate; and
- How management address this estimation uncertainty when selecting their point estimate.

For example, how management identified and considered alternative, methods, assumptions or source data that would be equally valid under the financial reporting framework, and why these alternatives were rejected in favour of the point estimate used.

The revised standard includes increased emphasis on the importance of the financial statement disclosures. Under ISA (UK) 540 (Revised December 2018), auditors are required to assess whether both the accounting estimates themselves and the related disclosures are reasonable.

Where there is a material uncertainty, that is where there is a significant risk of a material change to the estimated carrying value of an asset or liability within the next year, there needs to be additional disclosures. Note that not all material estimates will have a material uncertainty and it is also possible that an estimate that is not material could have a risk of material uncertainty.

Where there is material estimation uncertainty, we would expect the financial statement disclosures to detail:

- What the assumptions and uncertainties are;
- How sensitive the assets and liabilities are to those assumptions, and why;
- The expected resolution of the uncertainty and the range of reasonably possible outcomes for the next financial year; and
- An explanation of any changes made to past assumptions if the uncertainty is unresolved.

Planning enquiries

As part of our planning risk assessment procedures we have made formal inquiries of management. We would appreciate a prompt response to these inquiries in due course.

Further information

Further details on the requirements of ISA (UK) 540 (Revised December 2018) can be found in the auditing standard on the Financial Reporting Council's website:

[https://www.frc.org.uk/getattachment/0fa69c03-49ec-49ae-a8c9-cc7a2b65382a/ISA-\(UK\)-540_Revised-December-2018_final.pdf](https://www.frc.org.uk/getattachment/0fa69c03-49ec-49ae-a8c9-cc7a2b65382a/ISA-(UK)-540_Revised-December-2018_final.pdf)

