External Audit Report for Scottish Canals

Financial year ended 31 March 2021

Final report to those charged with governance and the Auditor General for Scotland

23 December 2021

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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 external audit 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 Scottish Canals 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.

Introduction

Scope of our audit work

This report is a summary of our findings from our external audit work for the financial year ended 31 March 2021 for Scottish Canals. The scope of our audit was set out in our External Audit Plan which was reported to the Audit and Risk Committee in March 2021.

The main elements of our audit work in 2020/21 have been:

- An audit of Scottish Canal's annual report and accounts for the financial year ended 31 March 2021. This includes the opening balance sheet transition as accounting under FReM for the first year.
- Consideration of the wider dimensions that frame the scope of public audit as set out in Audit Scotland's Code of Audit Practice 2016 ('the Code') covering: financial management; financial sustainability; governance and transparency and value for money; and
- Any other work requested by Audit Scotland.

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

This report is addressed to the Board and the Auditor General for Scotland and will be published on Audit Scotland's website www.audit-scotland.gov.uk in due course.

Responsibilities

Scottish Canals is responsible for preparing a annual report and accounts which show a true and fair view and that are in accordance with the accounts direction from Scottish Ministers. The Board is also responsible for establishing appropriate and effective arrangements for governance, propriety and regularity that enable it to successfully deliver its objectives.

The recommendations or risks identified in this report are only those that have come to our attention during our normal audit work and may not be all that exist. Communication in this report of matters arising from the audit or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

Adding value through our audit work

We aim to add value to Scottish Canals throughout our audit work. We do this through using our wider public sector knowledge and expertise to provide constructive, forward looking recommendations where we identify areas for improvement and encourage good practice around financial management and sustainability, risk and performance. In so doing, we aim to help the Board promote improved standards of governance, better management and decision making, and more effective use of resources.

Whilst the external audit for this year has been technically complicated, in respect of financial reporting and the FReM transition we have maintained a good working relationship with management and continued to have open and honest dialogue throughout the audit. We have kept management and the ARC up to date on the matters arising. We have sought to offer support and guidance, within the parameters of our external audit role, maintaining our auditor independence throughout.

We will reflect on the lessons learned, from us and management, and look to make further improvements to the audit process next year.

Audit of the annual report and accounts

Our audit opinion

For the financial year ended 31 March 2021 we will issue a disclaimer of opinion on the annual report and accounts. Our audit opinion is set out in full in Appendix 1 of this report.

Due to matters identified in relation to Property Plant and Equipment (PPE) we have determined we have insufficient audit evidence to conclude that the accounts are not materiality misstated or otherwise. This specifically relates to the £51million of assets held, classified as specialist-operational assets.

Recognising the value of PPE held within the Statement of Financial Position and the interrelated balances which impact the Comprehensive Income and Expenditure Statement (CIES) Statement of Cash Flow (CFS) and Statement of Comprehensive Tax Payers Equity (SOCTE) we have determined the pervasive nature of the impact on the annual report and accounts.

Detail on the PPE matters identified are set out in pages 6 to 10 of this report.

Materiality

The concept of materiality is fundamental to the preparation of the financial statements and the audit process and applies not only to the monetary misstatements but also to disclosure requirements and adherence to acceptable accounting practice and applicable law. Our audit approach was set out in our audit plan communicated to the Audit and Risk Committee in March 2021 and submitted to Audit Scotland.

We reviewed our planning assessment of materiality based upon the first version of the 2020/21 unaudited financial statements and concluded that materiality should be £0.340 million. This represents 1.7% of expenditure in-year. Performance materiality was set at £0.238 million, representing 70% of our calculated materiality. As set out in our audit plan, the benchmark for setting materiality, using expenditure, is still considered appropriate and in-line with our Public Sector audit approach.

We report to management any difference identified over £17,000 (calculated at 5% of planning materiality).

We applied a lower materiality threshold for disclosures within the Remuneration and Staff Report to ensure that remuneration has been disclosed within the appropriate bandings (being £1,000).

FReM Transition

From 1 April 2020 Scottish Canals became an NDPB. This had been discussed during 2019/20 with Management having a couple of months to plan ahead for the transition, including determining the impact on accounting requirements. As part of the transition, Scottish Canals needed to restate prior year opening comparatives and recognising the change in the basis of valuation, restate the opening balances as at 1 April 2019, to determine 31 March 2020, and 1 April 2020. Whilst many similarities in accounting between a Public Corporation and NDPB, as both IFRS based, differing accounting applies over valuation of PPE and deferred capital grant income, being the largest impact on Scottish Canals. For PPE, instead of holding at historic cost the FReM requires PPE to be held subject to a suitable basis of valuation. This change was what has caused Scottish Canals the biggest difficulty, and whilst identified for land and building, the valuation requirement for non-Investment property/Non-Land and building assets was not identified until July 2021.

Audit Process

In accordance with our audit plan, we planned to audit the opening balances transition to FReM in February 2021 in advance of the year-end audit, with our year end audit work planned to commence in May 2021. Our plan set out a timeline for signing the annual report and accounts by the end of August. This was the timeline agreed with Scottish Canal's sponsor team, Transport Scotland.

However, we were unable to audit opening balances as intended as these were not available until after the financial year end. We received a set of accounts at the beginning of May and a subsequent revised set at the beginning of June. These required numerous changes within the primary statements and the associated notes. This can be evidenced in Appendix 2.

As it was year one of reporting under the FReM, our public sector financial reporting team undertook a review of the accounts, to support the audit team. This identified further points for consideration including PPE valuation and wider PPE accounting, deferred capital income, group accounting, pensions, Income and contract accounting under IFRS 15. This resulted in increased management and audit time to resolve the matters.

When undertaking our PPE audit testing in June we were unable to reconcile the total value of assets disclosed as land, building and other structural assets in Note 8 of the unaudited accounts to the Gerald Eve Valuation. On further review, we noted circa £51million of this balance had not been valued by Gerald Eve as considered specialist-operational assets.

Therefore, these assets were not being accounted for correctly under FReM as remained at historic cost, and not subject to valuation.

Given the quality of the unaudited accounts received, and the PPE matter identified, alongside others related to opening balance transition we agreed a revised timeline for the audit to allow management to consider the audit matters and update the accounts and working papers. The timeline agreed, reflected our own availability of resourcing to conclude the audit, given this additional time was not planned.

The matters on PPE are technically complex resulting in additional audit work and management time. This extended the audit time required through to December 2021.

Scottish Canals appointed a new Director of Corporate Services, who started in late March 2021 and a Head of Finance (June 2021). Both were overseeing the annual accounts process for the first time, and in particular the more complex areas of judgement and estimates. Whilst the day to day finance team stayed the same, this loss of previous organisation wide accounting knowledge did impact on the ability to understand prior year accounting, and the underlying basis for certain accounting treatments.

Going forward we recommend a review of the future financial statement and audit timeline. Earlier quality review and challenge by management, will support the audit process through fewer versions of the accounts and ensure sufficient quality checks are in place before being ready for audit.

Lastly the annual report and accounts include a series of management judgements. Where management make judgements they need to set out to us as auditors the basis for the judgement, how that judgement is allowable under the FReM, what alternative judgements were considered (if any) and why. A greater clarity over the judgements made by management is required, to justify and support the audit process. See action plan.

Audit adjustments

The adjustments made, and unadjusted difference, identified through the audit, as a result of our audit procedures are set out in Appendix 2.

In addition, we identified a number of disclosure adjustments in respect of the unaudited financial statements, the more significant of these are detailed in Appendix 2.

In addition to the adjustments set out in Appendix 1 we identified a number of issues in respect of Property Plant and Equipment. These are set out in the following pages and resulted in our resultant disclaimer audit opinion.

Property, plant and equipment (PPE)

Scottish Canals as at 31 March 2021, in the annual report and accounts hold £105million in net assets. This balance is made up of:

- Investment property £26.7 million
- Land and buildings, specialist, vehicles, public artwork (£105 million)

Previously all assets were held at historic cost, subject to annual depreciation with the exception of Investment Property which is valued annually at fair-value. Under the FReM the accounting treatment of Investment property remains unchanged but all other asset categorises require valuation to be held at depreciated replacement cost (DRC) . As 2020/21 is the first year accounting under the FReM all assets require a formal valuation, to determine DRC.

Land and buildings were subject to external valuation during the year and the resultant valuation reflected in the unaudited annual report and accounts. However, management, in preparing for the FReM transition did not identify the need for circa £55million of other-infrastructure assets to be valued. Therefore, this was not in accordance with the FReM.

Following discussions, Management identified and commissioned a valuer, to value a proportion of these assets. The valuation completed was for our audit sample. Whilst this covered circa 95% of the total assets, it was not the complete population.

This valuation was undertaken in September and October 2021 on a desk-top basis using records prepared by Scottish Canals. The valuation was intended to determine DRC valuation, using indices the Valuer determined were appropriate This valuation report was shared with audit in November 2021. As a result of our review of the valuation work, in the context of other PPE matters, we reached a different judgement to management on the suitability of the valuation.

Matters identified over PPE

During the course of our audit we identified the following matters:

- The descriptions in the Fixed Asset register are not clear as to the historic type of asset and if the asset is a component, what is the overall asset the component relates to.
- We have been unable to get sufficient audit evidence to conclude on ownership of assets (rights and obligations). In particular has Scottish Canals enhanced, improved the economic benefit, of their asset, or someone else's asset for example towpaths. One instance was noted in year where work done by Scottish Canals had to be treated as a disposal, as did not create an asset that Scottish Canals owned, and another party was in ownership of the land.
- There is a risk of potential duplicate assets within the Fixed Asset Register. For example, initial difficulty by finance in reconciling the Gerald Eve valuation work (Investment Property and land and buildings) from property records, which informed the valuation to the FAR. In addition we noted many entries in the FAR related to the Falkirk Wheel Visitor centre, including certain balances which were categorised as specialist assets. As Gerald Eve Valued the Falkirk Wheel Visitor Centre as an Investment Property, we are unclear whether this may have resulted in a double count on assets.
- A review by management, during the audit, identified circa £0.5million of assets which were on the FAR which were not assets, the description did not allow the identification of the actual asset or were a duplicate entry. Without a formal asset verification exercise we are unable to conclude whether other assets remain recorded on the FAR in error, and whether this would be material.

Capital vs revenue

Scottish Canals main purpose is to maintain the Canal network (per the Transport Act). The Framework document, between Scottish Canals and Scottish Government, set this out alongside a regeneration and commercial purpose.

In order to recognise, and create a subsequent asset, in the Statement of Financial Position, Scottish Canals need to evidence, to audit, the criteria of the FReM has been met. In particular, the resultant capital spend has enhanced the economic benefit of the asset, or created a new capital asset. Under the FReM any resultant asset must be capable of valuation, to comply with FREM.

The Canal itself, does not have a value and is not accounted for in the Statement of Financial Position as an asset. Any historic balances held, pre dating the British Waterways Board being known as Scottish Canals, were written off under legislation, as a heritage asset of nil value.

Over time, under the current capitalisation arrangements, Scottish Canals will create a value, on the balance sheet, that represents the Canal.

From our review of capital additions in year we noted, a challenge in our judgement, compared with management judgement in this area, which we are unable to quantify, although note it is likely to be material:

- Certain expenditure in-year reinstated the canal back to its current use e.g., fixing a canal breach.
- Grants received often reference maintenance, within the purpose of the grant
- The ability of Scottish Canals to demonstrate the expenditure has enhanced economic benefit to Scottish Canals
- What was the underlying asset that the capital spend created and did it all create an asset, the way that it is currently recorded in the FAR.

Valuation

In addition to those outlined above, we note the following points on reviewing the valuation of the specialist-operational assets:

- The valuation was desk-top and did not consider or conclude on ownership of assets;
- The valuer, a specialist engineer by background, is not RICS qualified, and therefore the valuation did not link back to the relevant RICS guidance and confirmation with guidelines. To value specialist assets, it is acknowledged you do not have to be RICS qualified due to the nature of the asset. However, not all assets valued we would consider to be specialist-engineering in background. Therefore, would challenge in our judgement whether the valuer was sufficiently qualified to value all assets.
- It is unclear what is the actual asset that is being valued. Whilst being made up of many components the asset appeared to be valued as one asset. Based on the description, not all the components looked to be the same type and therefore we would challenge whether the index applied, was suitable, for all components making up the asset and the useful economic life assessed may also not be suitable. In most cases the useful economic lives being applied range from 25 years to over a hundred years. This would impact on resultant valuation and depreciation charge.
- In certain cases modern equivalent value (MEV) data may have been available, although this was not considered within the valuation.
- The indices were added onto the historic cost data provided by Management. There appeared to be little challenge by the valuer over whether this cost was representative of the cost of the asset.

- From a review of the descriptions of assets valued it is unclear how any potential double counting of assets was being considered. In certain cases moorings for example were mentioned. These are noted by management of being general moorings and separate from those within Investment property but this was difficult to evidence. If they are general moorings, then these would be of limited/low value. Other assets had a link to Investment Properties. In this case it is unclear whether the work undertaken, allowed the Investment Property to be an Investment property and generate income, and therefore captured in the Investment Property valuation already.

Deferred capital grants

Alongside the matters identified during the course of our audit we encountered difficulties over deferred capital grants. The previous accounting treatment was to release the capital grant over the life of the asset created. Under FReM this treatment is not allowable. Capital grants (as well as revenue grant) can only be deferred if there is specific criteria in the contract/funding letter relative to the use of the asset. Based on our testing we did not identify criteria to evidence justification for deferral. This was discussed with management and the opening balances re-visited, resulting in the recognition of circa £37m of capital grants. Our audit testing of this balance links to PPE accounting. In reviewing capital grant award letters we noted many referred to the "ongoing maintenance" of Scottish Canals. Therefore, a further consideration over whether the resultant spend by Scottish Canals does in fact meet capital accounting criteria.

Impact on the financial Statements

Given the matters outlined and the material nature of the balances we have reached a differing judgement than management related to completeness of fixed asset accounting records, ownership (rights and obligations to assets), valuation judgements and estimates including categorisation of assets to inform valuations and whether the spend represents an actual asset to Scottish Canals, which can in fact be valued per FReM or is spend incurred within Scottish Canals purpose of maintaining the canal network.

We note that this difference in judgment will be material to the annual report and accounts and we are unable to quantify the impact on the financial statements.

The balances impacted within the annual report and accounts include (*balances per V4 of unaudited accounts):

Statement of Comprehensive Net Expenditure:

- Depreciation and impairment of non-current assets (£2.265m)
- Other operating charges (£12.309m), namely Materials, maintenance, and repairs (£2.834m)

Statement of Financial Position

- PPE (£105.118m is the NBV of all assets)

Statement of Cash Flow

- Depreciation and impairment of non-current assets (£2.265m) and then presentation in individual lines in cash flow e.g., acquisition of PPE.

Statement of Changes in Taxpayers' Equity

- General Fund (£110.611m)
- Revaluation Reserve (£3.912m).

There may also be an impact on the deferred capital balances, including deferred capital income release.

Financial position and outturn for 2020/21

Financial Position 2020/21

Grant funding

The annual report and accounts disclose annual grant-in-aid funding from Scottish Government in-year of £9.6million. The total grant-in-aid increased during year from the baseline funding set at £8.5million, by £1.1million. This additional funding was made available to support Scottish Canals through the impact of Covid-19, including a reduction in forecast income, and to support revenue pressures in-year.

In addition to core grant funding £2.8million was also received from Scottish Government. This funding was used to make a payment to HMRC, towards an outstanding VAT liability. A total circa £8million remains due to HRMC as a result of the VAT review, and this balance is shown in the year end accruals as payment due in 12 months.

Income

Year on year income has reduced between 2019/20 and 2020/21 due to the impact of Covid-19 on Scottish Canals activities. In particular, more significant movements include:

- Retail income down 78% moving from £3.6million in prior year to £0.779million as at 31 March 2021
- A drop in 15% in rental income and a reduction from other income sources

Furlough

Scottish Canals recognise in the annual report and accounts furlough received of £746,000.

Expenditure

Alongside a reduction in income, expenditure in certain areas of the organisation also reduced reflecting a decrease in activity. Whilst staff costs remain relatively consistent year-on-year for permanent staff, there was a reduction in 2020/21 was staff costs associated with seasonal employees. In prior year 39 individuals were employed on seasonal/temporary contracts and in this year this reduced to 10.

Other operating charges reduced from £20.8million to £11.6million. This change can be attributed to 2019/20 including the initial VAT accrual of £7million, of which a further £4.8million has been accrued in 2020/21. In addition, a decrease in cost of sales of £2.2million, with a reduction in material, maintenance and repairs decreasing by £1.1million as a result of a decrease of activity, due to Covid-19.

Capital expenditure

Capital funding of £12.2million was received from the Scottish Government within Scottish Canals capital budget allocation. The final capital funding received in-year totalled £20.245million.

The additional capital funding received in-year included:

- Dredging of the Crinin and Caledonian Canals
- The breach within the Union Canal
- Replacement lock gates at a series of locations
- Investment in the claypits area

Responding to significant financial statement 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.

This section provides commentary on the significant audit risks communicated in the External Audit Plan.

Risks identified in our Audit Plan	Commentary

Management override of controls
 	
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.
	In response to this significant risk, our audit response was as follows:
	
	• We considered the design of controls in place over key accounting estimates and judgements through performance of walkthrough procedures.
	• We reviewed accounting estimates for management bias / indication of fraud that could result in material misstatement. This included review of estimates as at 31 March 2021 and retrospective review of those estimates as at 31 March 2020.
	• Journals testing including:
	  • Assessment of the design of controls in place over journal entries, including journal preparation, authorisation and processing onto the financial ledger;
	  • Risk assessment of the journals population to identify large or unusual journal entries, such as those that are not incurred in the normal course of business, or those entries that may be indicative of fraud or error that could result in material misstatement. We tested these journals to ensure they were appropriate and suitably recorded in the financial ledger;
	  • Target testing of transactions and journals posted around the financial year end, reviewing to understand the rationale for these entries.
	
	Conclusion
	
	We can confirm that we did not find evidence of management override of controls in our testing of journal transactions or any instances of material error. Furthermore we did not identify any indication of fraud or inappropriate management bias in accounting estimates that could result in a material misstatement.
	
	The annual report and accounts include an accounting policy on management judgements and critical estimates. The current disclosure could be further improved, to demonstrate full compliance with the FReM. For example: not all that is included here meets the definition of a judgement or critical estimate, the need for greater clarity over what the judgement and estimate is, why that was adopted, and the impact of the judgement on the financial statements, to support the user of the accounts in understanding the impact. See Action plan.

Risks identified in our Audit Plan	Commentary
Risk of fraud in revenue recognition 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.	In response to this significant risk, our audit response was as follows: • Walkthroughs of the controls and procedures over material revenue streams; • Substantive testing of revenue recognised during 2020/21 to confirm its occurrence and accuracy of recording; • Focused substantive testing of revenue recognised pre and post year end to identify if there is any potential overstatement or understatement to address the risk of cut-off; and • Detailed testing of trade and other receivables (where material) to gain assurance over the occurrence and accuracy of these balances as at year end. **Conclusion** Through audit procedures performed we did not identify any exceptions in relation to the occurrence, accuracy or completeness of revenue recognised by Scottish Canals during 2020/21. No exceptions were identified as a result of focused testing performed in relation to the risk of cut-off. As a result of our substantive procedures and sample testing we did not identify any income which was not in accordance with the nature of Scottish Canals (regularity testing). We have gained assurance in relation to the recoverability of year end debtor balances and are satisfied that these balances have occurred and have been recorded accurately.

Risks identified in our Audit Plan	Commentary
Risk of fraud in Expenditure recognition 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. .	In response to this significant risk, our audit response was as follows: • Walkthroughs of the controls and procedures over non-payroll expenditure, as related to the significant audit risk; • Substantive testing of expenditure throughout the year to confirm its occurrence and completeness of recording; • Focused substantive testing recognising pre and post year end to identify if there is any potential overstatement or understatement to address the risk of cut-off; • Review of accruals and provisions, where material, around the year end to consider if there is any indication of overstatement or understatement of balances held at year end through consideration of accounting estimates; and • Unrecorded liability testing to confirm the completeness of year end liabilities as well as the completeness of expenditure recognised during the year. Conclusion Through our audit procedures performed we did not identify any exceptions in our year end cut-off testing of expenditure. We did not identify any exceptions in the completeness and accuracy of accruals or payables balances at year end, subject to the points raised on PPE and the potential impact on expenditure identified.

Risks identified in our Audit Plan	Commentary
Valuation of Property, Plant and Equipment (PPE) 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 suitable 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 (and other structures) 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.	**Investment Property** In response to this significant risk, our audit response was as follows: • Walkthroughs of the controls and procedures over the valuation of investment properties; • Consideration of the arrangements in place at Scottish Canals for ensuring the carrying value of investment properties is appropriate and in accordance with IAS 40 and IFRS 13; • Evaluation of the competence, capability and objectivity of Scottish Canals professional valuer who represent management's experts under ISA 500; • Confirmed the completeness and accuracy of underlying information provided by Scottish Canals and used by the valuer in arriving at the valuation of investment property as at 31 March 2021; • Agreed the valuation report provided by the valuer to the underlying accounting entries made in the 2020/21 financial statements; • Challenged the appropriateness of the assumptions adopted by the valuer; • Challenged management's assessment of potential impairment of investment property including consideration of any indicators of impairment of investment property not recognised; and • Used our auditor's valuation expert in order to challenge Scottish Canals management of the valuation instructions issued and approach adopted in valuing investment property as at 31 March 2021 **Conclusion** Scottish Canals commission independent valuations of its assets on an annual basis. The valuations is conducted by an independent, registered valuer, in accordance with the Royal Institute of Chartered Surveyors (RICS) requirements. Similar to prior year the Valuer has noted a material uncertainty arising due to the impact of Covid-19 on the market. This is in accordance with RICS guidelines. This material uncertainty has arisen pinpointed to Scottish Canals investment properties that are deemed hospitality in nature. This is circa £2million of a £23million Investment portfolio. Whilst material in terms of our audit materiality, we do not consider this to be material to the users of the accounts as only 8% of total investment portfolio asset base. In addition, it was considered of reduced significance to the users, also, in the context of the financial statements disclaimer opinion. Based on our testing we conclude that investment properties have been valued in accordance with the FReM and that the assumptions adopted by management and their valuer are deemed reasonable.

Risks identified in our Audit Plan	Commentary
Valuation of Property, Plant and Equipment (PPE) (Continued from page 14)	**Land and buildings (circa £8 million)** In response to this significant risk, (Land and Buildings) our audit response was as follows: • Walkthroughs of the controls and procedures over the valuation of PPE; • Consideration of the arrangements in place at Scottish Canals for ensuring completeness and accuracy of the Fixed Asset Register • Evaluation of the competence, capability and objectivity of Scottish Canals professional valuer who represent management's experts under ISA 500; • Confirmed the completeness and accuracy of underlying information provided by Scottish Canals and used by the valuer in arriving at the valuation of Land and Buildings • Challenged the appropriateness of the assumptions adopted by the valuer (Land and Buildings and specialist-operational); • Challenged management's assessment of potential impairment including consideration of any indicators of impairment not recognised; and • Used our auditor's valuation expert in order to challenge Scottish Canals management of the valuation instructions issued and approach adopted in valuing Land and Buildings as at 31 March 2021, alongside an early initial view on the specialised-operational asset valuation. **Land and buildings summary** Based on our testing we conclude that land and buildings (circa £8million) have been valued in accordance with the FReM and that the assumptions adopted by management and their valuer are considered reasonable. **Other assets (specialist –operational)** See PPE Section of our report. Overall we were unable to gain sufficient audit evidence to determine whether the £51million of assets held as specialist-operational assets is not materially misstated. We are unable to conclude on the completeness and accuracy of the valuation, including the appropriateness of the assumptions. This then impacts on the underlying accounting entries, within the annual report and accounts.

Risks identified in our Audit Plan	Commentary
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.	In response to this significant risk, our audit response included: • A focused predominantly around the key assumptions used in the actuarial valuation, where there was an increased risk of material misstatement; • We performed walkthroughs of the controls and procedures over the valuation of defined benefit pension liabilities, including management oversight of the valuation; • We considered the work of the actuary for Strathclyde Pension Fund (Hymans Robertson UK LLP), including the assumptions applied, using the work performed by PwC (commissioned on behalf of Audit Scotland to review actuarial assumptions proposed by LGPS actuaries); • We considered the work of KPMG as the Pension Auditor for the Waterways Pension Fund and our auditor experts, within our Pensions team, to review pension assumptions. • We sought the necessary assurances over assets held and membership data, and employer and employee contributions in the year, for both Pension Schemes; • Under the Audit Scotland Pension Fund protocols we wrote and received a response from Audit Scotland as the external auditor of Strathclyde Pension Fund. • We performed substantive analytical procedures in the year over the pension fund movements, investigating any deviations from audit expectation; • We reviewed the accounting entries and disclosures made within the annual report and accounts in relation to IAS 19; and • We evaluated the competence, capability and objectivity of the work performed by management's expert and the work performed by auditor's expert under ISA 500 (UK) and ISA 620 (UK). **Conclusion** Through our audit procedures performed we did not identify any exceptions in our review and testing over IAS 19 defined benefit pension liabilities recognised in the financial statements. Through considering the work performed by auditor experts, we are satisfied that the assumptions applied by the actuary are reasonable. We have noted scope in the future to improve pension disclosures, and this is captured within appendix 2.

Responding to significant financial statement risks (continued)

Risks identified in our Audit Plan	Commentary
Accounting under the FReM for the first time as an NDPB 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.	Our areas of audit focus included: • An internal "hot review" of the unaudited annual report and accounts by our PSA financial reporting team. This review supports our audit team in identifying incorrect and/or financial reporting errors. • Testing of opening balance sheet transition confirming the correct adjustments have been made in accordance with the FReM. • Testing focused on Note 3 in the annual report and accounts. In particular we sought audit assurance over PPE transactions, Deferred Capital transactions and the fundings adjustments required in the CIES. • Review of opening balance sheet and transition to FReM disclosures within the annual report and accounts. • Completion of the FReM disclosure checklist. In preparing for the transition to FReM the need to hold assets (infrastructure, specialist, operational assets) on a valuation basis rather than historic cost was only identified by Management in June 2021. The need was identified on land and buildings, but management did not identify the same requirements to apply over specialist-operational assets (£51 million). This resulted in late consideration of valuation, and contributed to audit delays and ultimately the resultant opinion. **Audit Conclusion** The annual report and accounts for 2020/21 comply with the FReM except for valuation of specialist-operational assets. This departure from FReM is set out in the Accounting Policies, within the annual report and accounts. Given the matters identified, and reported here, in respect of PPE, management determined the most accurate reporting figure for 2020/21 remained historic cost, rather than the resultant valuation undertaken. See PPE commentary. Deferred capital income was, as a public corporation, released over the life of the resultant asset. However, under the FReM this accounting treatment is not allowable. Income can only be deferred when specific criteria are set out in the funding agreement/contract, otherwise the income is to be accounted for as income in-year. This has resulted in a significant change. Deferred capital income of £37 million has been adjusted within the opening balances. We have raised an audit recommendation for management on future contract/funding arrangements and accounting treatment (see audit action plan). There is an opportunity for management to enhance reporting under the FReM going forward, in particular, over disclosure of critical accounting estimates and judgements (see audit action plan)

Other reporting matters

Detecting Irregularities, including fraud

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, to detect material misstatements in respect of irregularities, including fraud. Owing to the inherent limitations of an audit, there is an unavoidable risk that material misstatements in the financial statements may not be detected, even though the audit is properly planned and performed in accordance with the ISAs (UK).

The extent to which our procedures are capable of detecting irregularities, including fraud is detailed below:

- We obtained an understanding of the legal and regulatory frameworks that are applicable to Scottish Canals and determined that the most significant which are directly relevant to specific assertions in the financial statements are those related to the reporting frameworks; International Financial Reporting Standards and the 2020/21 HM Treasury Financial Reporting Manual (FReM).
- We enquired of management and the Audit and Risk Committee, concerning Scottish Canals policies and procedures relating to the identification, evaluation and compliance with laws and regulations; the detection and response to the risks of fraud; and the establishment of internal controls to mitigate risks related to fraud or non-compliance with laws and regulations.
- We enquired of management and the Audit and Risk Committee, whether they were aware of any instances of non-compliance with laws and regulations or whether they had any knowledge of actual, suspected or alleged fraud.
- We assessed the susceptibility of Scottish Canals financial statements to material misstatement, including how fraud might occur, by evaluating management's incentives and opportunities for manipulation of the financial statements. This included the evaluation of the risk of management override of controls. We determined that the principal risks were in relation to journal entries that altered Scottish Canals financial performance for the year and potential management bias in determining accounting estimates, especially in relation to the valuation of PPE as at 31 March 2021. Our audit procedures are documented within our response to the significant risk of management override of controls on page 10 and valuation risk within PPE on page 14.
- These audit procedures were designed to provide reasonable assurance that the financial statements were free from fraud or error. However, detecting irregularities that result from fraud is inherently more difficult than detecting those that result from error, as those irregularities that result from fraud may involve collusion, deliberate concealment, forgery or intentional misrepresentations. Also, the further removed non-compliance with laws and regulations is from events and transactions reflected in the financial statements, the less likely we would become aware of it.
- The team communications in respect of potential non-compliance with relevant laws and regulations, included the potential for fraud in revenue recognition and significant accounting estimates.
- In assessing the potential risks of material misstatement, we obtained an understanding of:
  - Scottish Canals operations, including the nature of its operating revenue and expenditure and its services and of its objectives and strategies to understand the classes of transactions, account balances, expected financial statement disclosures and business risks that may result in risks of material misstatement. See additional commentary over our annual report (opinion), which further explains matters arising in this context.
  - Scottish Canals control environment, including the policies and procedures implemented by Scottish Canals to ensure compliance with the requirements of the financial reporting framework.

Significant estimates and judgements

Scottish Canals financial statements include several significant accounting estimates and judgement impacting on the annual accounts. We have captured our assessment in this section, where we believe a significant estimate or judgement is made. We note that accounting polices (Note 1) in the accounts outline more areas than we have captured here. We don't believe, in accordance with the FReM and ISA 540these are significant estimates and judgements. These areas are captured in Appendix 2.

Significant judgement or estimate	Summary of management's approach	Audit Comments	Assessment
Investment Property Valuation (£26.7m)	In accordance with the FReM requirements and IAS 40 and IFRS 13 Scottish Canals portfolio of investment property assets have been subject to an annual valuation. Scottish Canals have an appointed external valuer who is RICS qualified who has undertaken and reported on the valuation.	See comments set out on page 14, as Investment Property Valuations were considered a significant audit risk within our audit plan. Based on our audit work and challenge of management and management expert (the Valuer) we can conclude that the assumptions made are reasonable, and consistent with prior year assumptions.	● Light purple
Land and Buildings (£8 million)	Similar to Investment properties, land and buildings million have been subject to an independent valuation for the first time this year, as FReM has been adopted. The valuer appointed, Gerald Eve, also valued the investment properties.	Under RICS methodology the valuer has determined the valuation as at 31 March 2021 of the land and buildings held by Scottish Canals. This takes into account comparable market data and considers location, size and condition of the assets. The movement, in valuation as at 31 March 2021 compared to carrying value in prior year (historic cost) has been treated in the annual accounts appropriately.	● Light purple
Specialist-operational assets (£51 million)	In the first version of the unaudited annual report and accounts these assets had not been subject to valuation. To comply with the FReM management sough to, and identified who they considered to be a suitable valuer, to undertake a valuation of these assets. Whilst a valuation was provided, we were unable to gain sufficient audit assurance from this valuation. This was discussed in November 2021 following the valuation and there have then been subsequent conversations on the solution to the matters identified, required by Scottish Canals, and the timeframe to which this is possible. Therefore this valuation is not reflected in the final annual report and accounts. Therefore, in the final accounts this balance is held at historic cost, depreciated over a useful economic life determined by management. This is not in accordance with FReM.	See commentary in PPE Section. Overall we disagree with managements judgements that underpin the estimate, including certain of the judgements within the valuation report received, and whether that allows Scottish Canals to fully comply with FReM. This relates to the capital or revenue nature of the expenditure that has given rise to the assets, and what the resultant asset is, the classification of the assets (determining its valuation in the annual report and the accounts) and the rights and obligations to the asset. Recognising our materiality level and the total balance in the Statement of Financial Position we believe this could be potentially misstated.	Dark Purple

Assessment

- ● Dark Purple We disagree with the estimation process or judgements that underpin the estimate and consider the estimate to be potentially materially misstated
- ● Blue We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider optimistic
- ● Grey We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider cautious
- ● Light Purple We consider management's process is appropriate and key assumptions are neither optimistic or cautious

Significant judgement or estimate	Summary of management's approach	Audit Comments	Assessment
Actuarial gains/losses on Pensions and post benefit retirements	Scottish Canals has provided for an estimated liability relating to the Council's share of the net liability in the Strathclyde pension fund and the British Waterways Pension Fund. There are several assumptions within both scheme valuations including discount rate, future return on scheme assets, mortality rates, and future salary projections. The assumptions are informed by an actuary (Hymans Robertson for Strathclyde Pension Scheme and KPMG for British Waterways).	As noted in our response to significant risk section, using the work of PwC and our pensions team, we reviewed the key assumptions underpinning the actuarial valuation. We are satisfied that the assumptions adopted were appropriate and that those applied were considered reasonable i.e. within our acceptable tolerances. We did not identify any indication of management bias in the underlying assumptions applied in the estimate, and the key sensitivities surrounding these are reported in the annual report and accounts, as required per FReM. As noted in other areas of the financial statements, disclosures could be enhanced in the 2021/22 annual report and accounts. This is captured in a management action in the action plan, and within our disclosure adjustments, where relevant.	● Light purple

Assessment

- ● Dark Purple — We disagree with the estimation process or judgements that underpin the estimate and consider the estimate to be potentially materially misstated
- ● Blue — We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider optimistic
- ● Grey — We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider cautious
- ● Light Purple — We consider management's process is appropriate and key assumptions are neither optimistic or cautious

Significant judgement or estimate	Summary of management's approach	Audit Comments	Assessment
Investments	Scottish Canals do not prepare group accounts. The joint-venture/Associate equity accounting method has been prepared, in accordance with the FReM. Investments in joint ventures are disclosed in the CIES and within the relevant notes to the annual report and accounts.	We have reviewed the Scottish Canals group reporting structure in addition to managements own assessment of control. We have confirmed the accounting, is correct, in accordance with the FReM and group accounts are not required.	Light purple
VAT Liability	In prior year Scottish Canals disclosed a potential VAT liability, recognised within accruals. This arose due to a claim from HMRC related to previous VAT treatment, and what did or didn't constitute as a VAT exempt activity. In year Scottish Canals paid £2.8million, in the form of a non-prejudice payment to HRMC. The outstanding balance, circa £8million is once again shown as a creditor – accrual. Management have determined an accrual is the correct accounting treatment as are certain a payment is required and they are able to reliably estimate an amount. This is also referenced within the upfront annual report, within the financial commentary.	We have reviewed the correspondence between Scottish Canals and HRMC. We note the advice and ongoing discussions with the Scottish Government VAT team, alongside Scottish Canals VAT advisers. The value accrued for is based on advance received and correspondence with HRMC. This takes into account a payment made in-year, towards the outstanding liability. We consider this estimate to be reasonable.	Light purple
Deferred Tax	Scottish Canals accounts disclose taxation and a deferred tax balance. The tax computation has been undertaken by Scottish Canals tax advisers.	We have used our tax team to review the tax disclosures within the accounts. Enhancements have been identified, in accordance with IAS 12: Income tax, which will be considered by management in 2021/22 accounts. We note the tax computation was undertaken on an earlier version of the financial statements and may be required to be re-done on the final version. This may impact the deferred tax balance. However, our disclaimer opinion, does not form an opinion on the tax disclosed.	Light purple

Assessment

- Dark Purple We disagree with the estimation process or judgements that underpin the estimate and consider the estimate to be potentially materially misstated
- Blue We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider optimistic
- Grey We consider the estimate is unlikely to be materially misstated however management's estimation process contains assumptions we consider cautious
- Light Purple We consider management's process is appropriate and key assumptions are neither optimistic or cautious

Other key elements 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 focus either in accordance with the Audit Scotland Code of Audit Practice or ISAs or due to their complexity or importance to the user of the accounts:

Issue	Commentary
Matters in relation to fraud and irregularity	It is Scottish Canals responsibility to establish arrangements to prevent and detect fraud and other irregularity. As auditors, we obtain reasonable assurance that the financial statements as a whole are free from material misstatement, whether due to fraud or error. We obtain annual representation from management regarding management's assessment of fraud risk, including internal controls, and any known or suspected fraud or misstatement. We have also made inquires of internal audit around internal control, fraud risk and any known or suspected frauds in year. We have not been made aware of any incidents in the period, other than the two reported in year to the Audit and Risk Committee, and no issues in relation to these areas have been identified during the course of our audit procedures.
Accounting practices	We have evaluated the appropriateness of Scottish Canals accounting policies, accounting estimates and financial statement disclosures. We have identified and agreed a number of disclosure enhancements (see Appendix 2). These can be further enhanced in 2021/22. We note the Accounting polices as set out are in accordance with the FReM, with the exception of valuation of specialised-operational assets, which are held at historic cost as that was determined to be the best estimate at this point in time. We note, in respect of our opinion, the challenge over PPE accounting policies particularly Valuation, Asset categorisation, asset lives, and the resultant depreciation calculation.
Matters in relation to related parties	We are not aware of any related parties or related party transactions which have not been disclosed.
Matters in relation to laws and regulations	You have not made us aware of any significant incidences of non-compliance with relevant laws and regulations and we have not identified any incidences from our audit work.
Other information	We are required to give an opinion on whether the other information published together with the audited financial statements (including the Annual Report), is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. Within our audit opinion we have extended the disclaimer audit opinion to this information, where the information includes balances disclosed within the financial statements.
Remuneration and staff report	We are required to give an opinion on whether the parts of the Remuneration and Staff Report subject to audit have been prepared properly in accordance with the Accounts Direction issued by Scottish Government and in a form directed by Scottish Ministers in accordance with the Scottish Public Finance Manual. We have audited the elements of the Remuneration and Staff Report , as required by the Code and are satisfied that these have been properly prepared in accordance with applicable legislation. We note the medium pay calculation has been calculated taking into account the Chief Executive/Accountable Officer's salary. This differs from that disclosed in the Remuneration table, as pension contributions have been removed, as allowable per the FReM.

Issue	Commentary
Governance report	The Governance Report is set out in the Annual Report and Accounts. The report sets out how Scottish Canals has been governed during 2020/21, including Board and Audit & Risk Committee members and how they support the achievement of Scottish Canals objectives and includes the Statement of Accountable Officer's Responsibilities. In accordance with the Scottish Public Finance Manual ("SPFM"), the Accountable Officer has a specific responsibility to ensure that arrangements have been made to secure Best Value for Scottish Canals as well as Value for Money for the public sector as a whole. Through our audit work over the wider scope audit dimensions we have considered the arrangements in place at Scottish Canals for securing Best Value. Wider assurances through financial and non-financial performance and internal controls and governance arrangements, provide assurances to the Accountable Officer to express an opinion on the status of governance arrangements during the year for the purposes of updating the governance statement in the annual report. The governance statement also reflects the assurances and conclusions reached by the Board's Internal Audit function in year.
Matters on which we report by exception	We are required by the Auditor General for Scotland to report to you if, in our opinion: adequate accounting records have not been kept; or the financial statements and the audited part of the Remuneration and Staff Report are not in agreement with the accounting records; or we have not received all the information and explanations we require for our audit, or there has been a failure to achieve a prescribed financial objective. We have given a disclaimer of opinion. On this basis we have not received all information and explanation we require to conclude sufficiently our audit procedures, and are unable to confirm adequate accounting records have been kept, as set out in the Opinion (Appendix 1) and the PPE section of this report.
Written representations	A letter of representation has been requested from Scottish Canals, which will be signed when the annual report and accounts are signed. These representations come to us from Management and have been suitably tailored to recognise the basis of disclaimer opinion for 2020/21.
Going concern	In performing our work on going concern, we have had reference to Statement of Recommended Practice – Practice Note 10: Audit of financial statements of public sector bodies in the United Kingdom (Revised 2020). The Financial Reporting Council recognises that for particular sectors, it may be necessary to clarify how auditing standards are applied to an entity in a manner that is relevant and provides useful information to the users of financial statements in that sector. Practice Note 10 provides that clarification for audits of public sector bodies. Practice Note 10 states that if the financial reporting framework provides for the adoption of the going concern basis of accounting on the basis of the anticipated continuation of the provision of a service in the future, the auditor applies the continued provision of service approach set out in Practice Note 10. The financial reporting framework adopted by Scottish Canals meets this criteria, and so we have applied the continued provision of service approach. In accordance with Audit Scotland guidance: Going concern in the public sector, we have therefore considered Management's assessment of the appropriateness of the going concern basis of accounting and conclude that: • a material uncertainty related to going concern has not been identified; and • management's use of the going concern basis of accounting in the preparation of the financial statements is appropriate. Within our wider scope reporting we set out our conclusions on the financial sustainability of Scottish Canals.
Regularity	The Accountable Officer is responsible for ensuring the regularity of expenditure and income. We are responsible for expressing an opinion on the regularity of expenditure and income in accordance with the Public Finance and Accountability (Scotland) Act 2000. Given the basis for disclaimer opinion, we are therefore, unable to provide an opinion on regularity.

Wider scope audit

As set out in our Audit Plan, public audit in Scotland is wider in scope than financial audit. This section of our report sets out our findings and conclusion on our audit work on the wider scope audit dimensions: financial management; financial sustainability; governance and transparency and value for money. We take a risk based audit approach, utilising our cumulative audit knowledge of the organisation and understanding of its risks and priorities. Within our annual audit plan we identified 3 significant wider scope risks in relation Financial Sustainability, Governance and Transparency and Value for Money.

Wider scope dimension	Wider scope risk identified in our audit plan	Wider scope audit response and findings	External Audit conclusion
Financial Management Financial management is about financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively	No significant wider scope risks identified	We did not identify any significant wider scope financial management risks within our audit planning. Finance Team capacity and capability. During the year there has been planned turnover in the finance team. The Head of Finance left the organisation in the summer 2020, and this is disclosed in the exit costs within the annual report and accounts. As a temporary option a contractor was employed for a 9 month period of time to provide support and cover within the finance team in the role of Senior Financial Accountant. In addition, as reported last year, a Director of Corporate Services was seconded from another public sector organisation, from the period January 2020 to May 2021. Permanent solutions were sought, with a new Director of Finance and Corporate Services starting with the organisation in March 2021 and a new Head of Finance recruited in late May 2021. Since June 2021 a project has been ongoing to re-review and update financial procedures. To date this has included updated Standing Financial Instructions. In addition, a review of the financial team structures is going on.	The recruitment to the two posts within Finance will strengthen the financial management arrangements within Scottish Canals. During 2021/22 management should continue to review the finance structure and the financial controls in place to ensure they remain effective and efficient. This includes the ongoing review of capital accounting being undertaken.

Wider scope dimension	Wider scope risk identified in our audit plan	Wider scope audit response and findings	External Audit conclusion
Financial Management (continued) Financial management is about financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively	No significant wider scope risks identified	Accounting as an NDPB. From 1 April 2020 Scottish Canals became an NDPB (previously a public corporation). Whilst certain accounting treatment remained the same there are differences between the FReM and Companies Act resulting in Scottish Canals needing to account differently this year. This includes valuation of all PPE assets, treatment of deferred capital grants and the classification of funding. During 2021/22 management should continue to ensure that the internal control environment is aligned to reporting under the FReM and that management accounts are updated where needed, to support year-end reporting. Capital projects and accounting Scottish Canals have identified a need to strengthen its approach to capital accounting. Over the last 2 years there has been an increase in capital funding via capital grant-in-aid from Scottish Government, resulting in significant increases in capital expenditure. Initially held at cost as Assets Under Construction (AUC) in the Statement of Financial Position, on completion, under the FReM, if creating an asset the asset will require a suitable valuation, or expenditure to be written off as an impairment. A capital accountant has been employed, on a fixed term contract for two years to support Scottish Canals capital accounting arrangements. Included within this role will be a review of the current Fixed Asset Register (FAR) and whether it is fit for purpose, alongside ensuring all assets are recorded on the FAR, subject to valuation and/or impairment review, and depreciated per Accounting Policies. This role will greater link the project work, with the financial reporting and accounting. [See action plan] Scottish Canals have in place a long term asset management plan, which sets out longer term asset/infrastructure requirements, including planned maintenance. See further commentary within Financial Sustainability.	See previous page for conclusion

Wider scope dimension	Wider scope risk identified in our audit plan	Wider scope audit response and findings	External Audit conclusion
Financial sustainability Financial sustainability looks forward to the medium and longer term to consider whether the Board is planning effectively to continue to deliver its services or the way in which they should be delivered.	**Significant risk identified:** 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.	**Corporate and Business planning** Scottish Canals has a corporate plan (2020-2023) and this is supported by annual business plans. The 2020/21 business plan was revisited during the year due to Covid-19. In particular the income financial forecasts were reassessed in light of closures and different scenarios considered and re-forecast. The 2021/22 business plan includes forecasted financial position alongside a recognition that as an organisation there will need to be continued flexibility, depending on the pandemic and recovery. **Financial forecasts 2021/22** The total budget for 2021/22 is £39.2 million. This is split as £12.2 million capital, £9.7 million in grant-in-aid Scottish Government funding with the remainder coming from 3rd party funding, and commercial income. Staff costs are forecast at £9.5 million, which is greater than the Scottish Government Funding. Overall Scottish Canals again in 2021/22 are reporting a deficit outturn position. This is in part due to the impact of Covid-19 on Scottish Canal's income during 20/21 which is in part recovering, albeit will remain a challenge in 2021/22 as the Covid pandemic continues. Overall the costs of running Scottish Canals alongside the required capital investment, which exceed capital funding are greater than funding and income generated. Over the short to medium term this does need to be addressed, either through a reduction and focus on cost control and/or greater income generation. A medium term financial strategy is being produced by the Director of Finance. This will be linked to any future discussions on the corporate structure of Scottish Canals, to allow Scottish Canals to fulfil its obligations under the Transport Act and the Framework document, agreed between Scottish Canals and Scottish Government. This medium term financial strategy will need to be linked to the future direction of Scottish Canals set by Scottish Government and the Board, and the savings/efficiencies generating from the digital investment[See action plan]	Scottish Canals are forecasting a deficit outturn for 2021/22. A medium to longer term financial strategy is required, linked to corporate and business planning which demonstrates at what point, and how Scottish Canals is able to operate a breakeven or surplus financial position. There is additional financial pressure due to the large VAT liability and it is likely that the outcome of the HR pay and reward review, will result in increase costs to Scottish Canals. It is unclear whether these can all be met from the current funding agreed for 2021/22.

Wider scope dimension	Wider scope risk identified in our audit plan	Wider scope audit response and findings	External Audit conclusion
Financial sustainability (continued) Financial sustainability looks forward to the medium and longer term to consider whether the Board is planning effectively to continue to deliver its services or the way in which they should be delivered.	Significant risk identified (continued):	VAT Disclosed in the annual report and accounts is a VAT liability of £8.886 million. This is an existing liability arising due to an investigation by HMRC in the recoverability of input VAT on expenditure. Scottish Canals VAT advisers KPMG are involved in the discussions alongside Scottish Government VAT experts. In 2020/21 a revenue payment of £2.8 million was made to HRMC as a goodwill gesture towards the liability. An additional £1million has been paid since 31 March 2021 from capital funding. Scottish Canals expect the full value, reflected in the accounts, will be paid during 2021/22. Whilst Scottish government recognise the liability, this has not been built into the funding for 2021/22. Scottish Government have advised that Scottish Canals looks to raise the monies for any eventual liability to date and any future annual pressures through their existing funding and resources. If savings cannot be generated by Scottish Canals to meet the liability there is an expectation that Scottish Government will offer support. Capital planning Scottish Canals has a 10-year asset management plan which is regularly reviewed and updated. On the basis of assessed risk, the plan considers maintenance requirements over the longer term. In addition, during the year Scottish Canals may need to undertake emergency canals work, for example a canals breach e.g. Muiravonside. In these cases additional capital funding may be provided to Scottish Canals from Scottish Government to cover one-off costs or the spend would need to be covered within the planned level of capital funding. A risk of canal failure and significant investment in maintaining the canal network is captured in the risk register. Decisions need to be made, linked to Scottish Canals financial position on what assets they can afford to maintain or whether an asset will ultimately fail, which will then need replaced, which may be more cost effective than repairing an aging asset. This will be linked to Scottish Canals Asset Management Plan.	See previous page for conclusion.

Wider scope dimension	Wider scope risk identified in our audit plan	Wider scope audit response and findings	External Audit conclusion
Financial sustainability (continued) Financial sustainability looks forward to the medium and longer term to consider whether the Board is planning effectively to continue to deliver its services or the way in which they should be delivered.	Significant risk identified (continued):	**Furlough** In 2020/21 Scottish Canals made use of the Government's furlough scheme. In total 83 staff were on furlough at the start of the pandemic (March to June 2020) and then again in wave 2 (January to March 2021). Government funding of £0.746 million was received which supported Scottish Canal's financial position in-year. This is disclosed in the annual report and accounts. **Dundashill (Investment Property)** Set out in the annual report and accounts within the post balance sheet note is the disclosure of the asset swap between Scottish Canals and BIGG, the Scottish Canals Joint Venture Partner. Scottish Canals purchased Bigg 100 Borron Street business park and Payne Street Industrial Estate in exchange for the sale to BIGG of 3 plots at Dundashill. This was approved in December 2020 by Scottish Government with the transactions legally concluded in June 2021. We will consider this transaction, and wider value for money including value for money achieved and evidenced in Scottish Canals respective joint ventures, within our 2021/22 external audit. **Overall organisational purpose** Many of our observations on financial sustainability are linked to the overall purpose of Scottish Canals as an organisation. The Transport Act sets out the responsibility to maintain the canal network. Scottish Canals currently undertake this activity alongside other income generating activities, and wider regeneration plans. Recognising the limited funding of Scottish Canals, the running costs that need to be met, and the increasing risk of failure, and therefore increased one-off funding to fix asset failures, there is a need to re-look and decide Scottish Canals core reason for operating and what that business model is that underpins the organisation. These discussions will need to take place between Scottish Canals, Transport Scotland (Sponsor department) and Scottish Government. See action plan.	See previous page for conclusion.

Wider scope dimension	Wider scope risk identified in our audit plan	Wider scope audit response and findings	External Audit conclusion
Governance and transparency Governance and transparency is concerned with the adequacy of governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.	A 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.	**Governance during Covid-19 and Board Governance** During the year Scottish Canals maintained its governance structures. The organisation moved to remote working for all roles where possible. The Board and sub-committees (Remuneration Committee and Audit and Risk Committee) met throughout the financial year using remote technologies. The Board met 16 times during the year, Audit and Risk Committee 4 and Remuneration Committee 6. We would note: - There is an opportunity in 2021/22 for the Board to meet less frequently. Whilst Covid-19 had a significant impact on income for Scottish Canals there is a risk that meeting with this frequency results in operational decision making rather than strategic oversight. This frequency may also not allow management sufficient time to prepare good quality papers for decisions or to implement decisions between meetings. An average NDPB Board would meet circa 8 times per annum, in our experience. - The Remuneration Committee is chaired by the Board Chair. All Non-Executive Board members are members of the Remuneration Committee. Therefore, this is effectively another Board meeting. We would recommend the Committee is chaired by another Non-Executive Director rather than the Chair and that the membership is reviewed and reduced appropriately. This would allow the Remuneration Committee to report to the Board, for Board consideration and be good governance practice. The Board Chair appointment was extended to March 2022 recognising Covid-19 and the need for continuity in this period of change from a Public Corporate to an Non-Departmental Public Body (NDPB). This post will be advertised in the Autumn through Scottish Government Public Appointments. **Audit and Risk Committee** During the year there has been some changes in membership of the Audit and Risk Committee. The Committee is chaired by a Non-Executive Board member, with another Non-Executive as a member. To supplement the skills of the Audit and Risk Committee there are two co-opted members. There has been significant turnover of the Committee membership via resignations. Looking forward to 21/22 it is hoped that there will be a period of stability on the Audit and Risk Committee, to support the continued focus on risk management and assurance. Scottish Canals should continue to be mindful of the balance of membership, 2 Non-Executives and 2/3 co-opted/Independent members to ensure this continues to meet the future needs of Scottish Canals and that skills are the additional skills required.	Scottish Canals continues to review its governance arrangements. This includes any revisions required now that Scottish Canals is an NDPB. We have identified further opportunities for Scottish Canals to enhance governance, namely a review of the frequency of Board meetings and the constitution of the Remuneration Committee. There has been, in the last two years, substantial turnover in the membership of the Audit and Risk Committee. Management and the Board should re-review the arrangement, of Board members and co-opted membership to ensure this is the right balance going forward and the committee has stable membership going forward. It is recommended that Scottish Canals agree with Scottish Government the draft Framework Direction as that will provide the governing framework for the organisation going forward.

Wider scope dimension	Wider scope risk identified in our audit plan	Wider scope audit response and findings	External Audit conclusion
Governance and transparency Governance and transparency is concerned with the adequacy of governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.	Significant risk identified:	Leadership Team During the year Scottish Canals were successful in recruiting into the two advertised Director posts. These posts were the Director of People, Safety and Governance and Director of Finance and Business Services, who commenced in February 2021 and March 2021 respectively. As a result of the new appointments, the seconded Director of Corporate Services (from Scottish Police Authority) ended their secondment in May 2021. One other seconded Director remains in place, through to January 2022 from the Scottish Government. The role was originally the Director of Policy and Governance, and changed during the year to Director of Revenue and Regeneration. In addition, as noted within our commentary on financial management a new Head of Finance joined Scottish Canals in May 2021. Chief Executive The Chief Executive (Accountable Officer) is on a 5-year secondment to Scottish Canals. This arrangement is due to end in 2023. Whilst a while away it is important that Scottish Canals continues to plan for this transition and the recruitment of a new Chief Executive, including a period of handover. Internal governance groups Scottish Canals have had many internal governance groups supporting to Executive Leadership Team in operational decision making during the year. Groups include: Financial planning; project assurance; regeneration and enterprise committee; digital change steering group; people forum and business delivery committee. There is an opportunity to review the number and nature of these groups, relative to the size of Scottish Canals to ensure each group has a valid purpose, linked to the corporate plan and business plan.	See previous page for conclusion

Wider scope dimension	Wider scope risk identified in our audit plan	Wider scope audit response and findings	External Audit conclusion
Value for money Value for money is concerned with using resources effectively and continually improving services.	Significant risk identified: No significant audit risks were identified within our audit plan in respect of Scottish Canals VFM arrangements.	Response to significant risk: As noted within this report Scottish Canals have a Corporate and a Business plan. The Framework Direction is in draft with Scottish Government and will be finalised during 2021/22. The Transport Act outlines Scottish Canals responsibility for maintaining the Scottish Canal network, to ensure continued economic use and the access to the public, for use of the canals. Alongside this the Act references the ability of Scottish Canals to generate income, through the acquisition; regeneration and sale of land alongside the Canal. From 1 April 2020 Scottish Canals changed from a Public Corporation to an NDPB. This may, overtime, result in a change in focus for Scottish Canals in the way that the organisation balances maintenance with commercial benefit. The capital plan acknowledges the significant cost, now and in the future, of maintaining the Canal network and the consistent investment required to look to reduce Canal failures for example breaches. This will drive Scottish Canal decision making, to support the demonstration of value for money. As noted in our financial statement audit we identified considerations over whether capital spend resulted in the creation of an asset or a component of an asset, or was maintenance and revenue in nature. If an asset is not created this may influence future decision making, and the organisation may spend money differently.	During our 2021/22 external audit we will further consider how Scottish Canals ensures it demonstrates value for money in decision making and balances priorities, maintenance and commercial benefit. This will include a consideration of the land-swap at Dundas Hill as already outlined, and other commercial income decisions

Appendices

1. Disclaimer of opinion (auditors report)

Independent auditor's report to the members of the British Waterways Board operating as Scottish Canals, the Auditor General for Scotland, and the Scottish Parliament

Reporting on the audit of the financial statements

Disclaimer of opinion on financial statements

We were appointed by the Auditor General for Scotland to audit the financial statements in the annual report and accounts of the British Waterways Board operating as Scottish Canals for the year ended 31 March 2021 under section 24 of the Transport Act 1962. The financial statements comprise the Statement of Comprehensive Net Expenditure, Statement of Financial Position, Statement of Cash Flow, Statement of Changes in Taxpayers' Equity and notes to the financial statements, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union, and as interpreted and adapted by the 2020/21 Government Financial Reporting Manual (the 2020/21 FReM).

We do not express an opinion on the accompanying financial statements. Because of the significance of the matters described in the *Basis for disclaimer of opinion* section of our report, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on these financial statements.

Basis for disclaimer of opinion

Within the Property, Plant and Equipment (PPE) balance of £105 million (net) are assets of £51million valued on an historical cost basis. Scottish Canals has classified these assets as specialist-operational assets. The 2020/21 FReM requires specialist-operational assets to be valued at current value in existing use, which represents the present value of the asset's remaining service potential. This differs from the requirements of the previous financial reporting framework used by Scottish Canals until 31 March 2020 which allowed the historical cost basis. We were unable to gain sufficient audit evidence to support the current value in existing use of these assets and as a result these assets remain recorded on an historical cost basis.

We were unable to obtain sufficient audit evidence to conclude on:

- The appropriateness of the capitalisation of the expenditure as specialist-operational assets. We could not determine whether any of this capitalised expenditure was incurred by Scottish Canals in maintaining the canal network, its primary purpose per the 1962 Transport Act, and should therefore have been treated as revenue expenditure.

- The valuation of the specialist-operational assets and the suitability of that valuation to evidence compliance with FreM requirements.

As a result of these matters, we were unable to determine whether any adjustments might have been found necessary in respect of the PPE balances recorded in the Statement of Financial Position, or associated revenue expenditure, including other operating charges (materials, maintenance and repairs), depreciation and impairments recorded in the Statement of Comprehensive Net Expenditure. This also impacts on the related entries in the Statement of Cash Flows and the Statement of Changes in Tax Payers Equity, including the General Fund and Revaluation Reserve balances. We have concluded that the possible effects on the financial statements of undetected misstatements could be both material and pervasive.

Conclusions relating to going concern basis of accounting

We have concluded that the use of the going concern basis of accounting in the preparation of the financial statements is appropriate. Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the body's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from when the financial statements are authorised for issue.

Risks of material misstatement

We report in a separate Annual Audit Report, available from the Audit Scotland website, the most significant assessed risks of material misstatement that we identified and our judgements thereon.

Responsibilities of the Accountable Officer for the financial statements

As explained more fully in the Statement of Accountable Officer's Responsibilities, the Accountable Officer is responsible for the preparation of financial statements that give a true and fair view in accordance with the financial reporting framework, and for such internal control as the Accountable Officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Accountable Officer is responsible for assessing the body's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless deemed inappropriate.

Auditor's responsibilities for the audit of the financial statements

Our responsibility is to conduct an audit of the financial statements in accordance with applicable law and International Standards on Auditing (UK) (ISAs (UK)) as required by the Code of Audit Practice approved by the Auditor General for Scotland, and to issue an auditor's report. However, because of the matters described in the *Basis for disclaimer of opinion* section of our report, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the financial statements.

We were appointed by the Auditor General on 19 May 2016. The period of total uninterrupted appointment is five years. We are independent of the body in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK including the Financial Reporting Council's Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. Non-audit services prohibited by the Ethical Standard were not provided to the body

Reporting on regularity of expenditure and income

Disclaimer of opinion on regularity

Because of the matters described in the *Basis for disclaimer of opinion* section of our report, we do not express an opinion on whether in all material respects the expenditure and income in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers.

Responsibilities for regularity

The Accountable Officer is responsible for ensuring the regularity of expenditure and income. In addition to our responsibilities to detect material misstatements in the financial statements in respect of irregularities, we are responsible for expressing an opinion on the regularity of expenditure and income in accordance with the Public Finance and Accountability (Scotland) Act 2000.

Reporting on other requirements

Basis of opinion prescribed by the Auditor General for Scotland on audited part of the Remuneration and Staff Report

We have audited the parts of the Remuneration and Staff Report described as audited. In our opinion, the audited part of the Remuneration and Staff Report has been properly prepared in accordance with section 24 of the Transport Act 1962 and directions made thereunder by the Scottish Ministers.

Statutory other information

The Accountable Officer is responsible for the statutory other information in the annual report and accounts. The statutory other information comprises the Performance Report and the Accountability Report excluding the audited part of the Remuneration and Staff Report.

Our responsibility is to read all the statutory other information and, in doing so, consider whether the statutory other information is materially inconsistent with the financial statements, or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether this gives rise to a material misstatement in the financial statements themselves. If, based on the work we have performed, we conclude that there is a material misstatement of this statutory other information, we are required to report that fact. As described in the *Basis for qualified opinion* section of our report, we were unable to determine whether any adjustments might have been found necessary in respect of the PPE balances or associated revenue expenditure and issued a disclaimer of opinion on the financial statements. Accordingly, we are unable to conclude on the other information as it relates to amounts in the financial statements.

Disclaimer of opinions prescribed by the Auditor General for Scotland on Performance Report and Governance Statement

Because of the matters described in the *Basis for disclaimer of opinion* section of our report, we do not express an opinion on whether:

- the information given in the Performance Report for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with section 24 of the Transport Act 1962 and directions made thereunder by the Scottish Ministers; and

- the information given in the Governance Statement for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with section 24 of the Transport Act 1962 and directions made thereunder by the Scottish Ministers.

Matters on which we are required to report by exception

We are required by the Auditor General for Scotland to report to you if, in our opinion:

- adequate accounting records have not been kept; or
- the financial statements and the audited part of the Remuneration and Staff Report are not in agreement with the accounting records; or
- we have not received all the information and explanations we require for our audit.

As set out in the Basis for disclaimer of opinion section of this report, we are unable to determine whether adequate accounting records have been kept and we have not received all information and explanations required for our audit

Conclusions on wider scope responsibilities

In addition to our responsibilities for the annual report and accounts, our conclusions on the wider scope responsibilities specified in the Code of Audit Practice are set out in our Annual Audit Report.

Use of our report

This report is made solely to the parties to whom it is addressed in accordance with the Public Finance and Accountability (Scotland) Act 2000 and for no other purpose. In accordance with paragraph 120 of the Code of Audit Practice, we do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

1. Audit Adjustments

We are required to report all non trivial misstatements to those charged with governance, whether or not the accounts have been adjusted by management. We are pleased to report there are no material uncorrected misstatements to the financial statements.

Impact of adjusted misstatements – 2020/21

The table below provides details of adjustments identified during the 2020/21 audit which have been made within the final set of financial statements.

Detail	Statement of Comprehensive Net Expenditure £000's	Statement of Financial Position £000's	Statement of Changes in Taxpayers' Equity £000's
Adjustment in relation to VAT liability as at 31 March 2020			
Dr Other Costs	1,175		
Cr VAT Liability		(1,175)	
Furlough claim accrual			
Dr Trade and Other Receivables		74	
Cr Income from Commercial Activities	(74)		
Ardrishaig Pontoon accrual			
Dr Staff Costs	72		
Cr Property, plant and equipment (Assets under construction)		(72)	
Disposals			
Dr Investment properties		2,501	
Dr PPE accumulated depreciation		415	
Dr General Reserves			615
Cr Depreciation	(21)		
Cr Property, plant and equipment		(1,009)	
Cr Deferred capital income		(2,501)	
Corporation Tax			
Dr Deferred tax asset		92	
Dr Corporation tax provision		1	
Cr General Reserves			(93)

Impact of adjusted misstatements – 2020/21 (Continued)

Detail	Statement of Comprehensive Net Expenditure £000's	Statement of Financial Position £ 000's	Statement of Changes in Taxpayers' Equity £000's
Revaluation adjustment			
Dr Investment properties		381	
Dr General reserves			3,502
Cr Property, plant and equipment		(3,388)	
Cr Revaluation reserve			(495)
CJRS Accrual			
Dr Customer recharges	35		
Cr Accruals		(35)	
Deferred income release			
Dr Deferred income		626	
Dr Deferred capital income		17,872	
Cr Income from commercial activities	(14,770)		
Cr General reserves			(3,728)
Overall impact	(13,583)	13,782	(199)

Impact of adjusted misstatements 2019/20

The table below provides details of adjustments identified in relation to 2019/20 opening balances, restated under transition to the FReM, which have been made within the final set of financial statements.

Detail	Statement of Comprehensive Net Expenditure £000's	Statement of Financial Position £000's	Statement of Changes in Taxpayers' Equity £000's
Disposals			
Dr PPE accumulated depreciation		393	
Dr Profit or loss on sale of fixed asset	70		
Dr General reserves			563
Cr Property, plant and equipment		(1,009)	
Cr Depreciation	(17)		
Adjustments to revaluation reserve for assets now matched			
Dr Investment properties		391	
Dr General reserve			3,502
Cr Property, plant and equipment		(3,156)	
Cr Revaluation reserve			(737)
Deferred income adjustment			
Dr Revenue	2,206		
Dr Deferred income		329	
Dr Deferred capital income		3,399	
Cr General reserves			(5,934)
Dundashill deferred income			
Dr Gain on revaluation of investment properties	4,117		
Cr Revenue	(4,117)		
Reverse release of deferred capital income to investment property			
Dr Investment properties		4,151	
Cr Deferred capital income		(4,151)	
Dr Deferred capital income		4,151	
Cr P&L	(4,151)		
Dr Gain on revaluation of investment properties	4,151		
Cr Investment properties		(4,151)	
Overall impact	2,259	347	(2,606)

Impact of adjusted misstatements 2018/19

The table below provides details of adjustments identified in relation to 2018/19, restated under transition to the FReM, which have been made within the final set of financial statements.

Detail	Statement of Comprehensive Net Expenditure £000's	Statement of Financial Position £000's	Statement of Changes in Taxpayers' Equity £000's
Disposals			
Dr Profit or loss on sale of fixed asset		563	
Dr PPE accumulated depreciation		358	
Cr Property, plant and equipment		(921)	
Adjustment to reval for assets now matched			
Dr Impairment	3,502		
Dr Investment properties		401	
Cr Property, plant and equipment		(3,309)	
Cr Revaluation reserve			(594)
Release of deferred income*Note 1			
		265	
Dr Deferred capital income < 1 year		5,668	
Dr Deferred capital income > 1 year	(5,933)		
Cr Income from commercial activities			
Overall impact	(2,431)	3,025	(594)

Note 1: Deferred Income

In the final annual report and accounts we identified a difference of circa £1.3million which we were unable to reconcile within the accounts. On discussion with management we note that the in-year balance and closing balance is correct, in the release of deferred income. Therefore, the error may sit in the opening balance in 2018/19. Given the disclaimer of opinion, and the likely review and subsequent amendment of opening balances in the 2021/22 accounts, arising due to the PPE matters outlined, management have not sought to identify the cause of this difference, and any required correction. We will consider the impact of this in our 2021/22 audit, as required.

Misclassification and disclosure changes

The table below provides details of the more misclassification and disclosure changes identified during the audit. Minor disclosure amendments were identified during Engagement Leader and Manager review and have been addressed. Below we draw your attention to the more significant disclosure changes requested and made.

Disclosure	Auditor recommendations	Adjusted?
Investment properties – estimation uncertainty	Insufficient disclosure to meet the requirements of IAS 1:125 in relation to the material estimation uncertainty in relation to the valuation of hospitality properties. For example the disclosure provides no sensitivity analysis or range of outcomes IAS 1:129.	No – Will be reviewed by management in 2021/22
Significant judgements and critical accounting estimates	The disclosure is not meant to disclose policies that have a critical effect but rather explain the rationale for the judgements that the audited body has made in applying those accounting policies as well as the effect this has had on the financial statements. Note 1.3 Estimates – Does not clearly state what the uncertainty is, or how it impacts on the accounts over the next 12 months.	No – Disclosures will be reviewed in 2021/22
IFRS 15 Revenue from contracts with customers	The accounting policy in respect of revenue needs to be updated in line with IFRS 15. For example, there is no mention of performance obligations, transaction prices, recognition at a point in time or over time, and the policy includes reference to property sales which would be accounted for under IAS 16 and leases which come under IAS 17. Not all disclosures applicable to IFRS 15 appear to be included in the accounts, however these are not considered material.	Yes to policy No to disclosures – will be picked up in 2021/22
Restatement	Reporting of the adjustment affecting the balances at 31 March 2020 and 31 March 2019 and the adjustment to the SOCNE 2019/20 – whilst the changes are analysed, the disclosure does not adequately explain the nature of the changes made. The explanation needs to cover the changes to the start of the comparative period 1 April 2019 – and then the movement through the SOCNE for 201920 to arrive at the restated 31/3/2020	Yes – In final annual report and accounts.
Capital Grant	Accounting policy states "Capital grants received are recognised under IAS 20 as deferred income and released to the SOCNIE over the expected useful lives of the assets concerned where the funder has imposed a condition on the grant that future economic benefits are consumed as specified by the grantor/donor." This reference to expected useful lives indicates that the requirements of the FREM are not being met. The FREM stipulates that an entity can only defer grant when there is a condition that is not yet met. Where a condition relates to a specified future event then the return obligation does not arise until it is expected that the condition will be breached.	Yes - In final annual report and accounts

Misclassification and disclosure changes

The table below provides details of the more misclassification and disclosure changes identified during the audit. Minor disclosure amendments were identified during Engagement Leader and Manager review and have been addressed. Below we draw your attention to the more significant disclosure changes requested and made.

Disclosure	Auditor recommendations	Adjusted?
Investment property	Notes to the account report that the investment property is measured at fair value and that all are considered to be level three in the fair value hierarchy. The disclosure requirements of IFRS 13 : 93 have not been met for example the description of the valuation techniques and inputs is very high level and there is no quantitative information about the significant unobservable inputs used in the fair value measurement and no description of the sensitivity to changes in unobservable inputs.	No
Scottish Canals as a Lessor	There are no disclosures relating to the entity as a lessor and yet it holds investment property and refers to lease arrangements in its accounting policies.	Yes – Additional disclosure added
Investment in other entities	Accounting policies state that the audited body has several arrangements that represent joint ventures. Note to the accounts refers to a wholly owned subsidiary company and entities reported as associates, with no mention of there being joint control and these being joint ventures.	Yes – Updated for clarity over group structure and consistent terminology
Investment in other entities	Accounting policy incorrectly states that non current investment are stated at cost.	Yes – Accounting policy updated
Financial instruments	Accounting policy does not provide a clear explanation of the classification, measurement and accounting treatment under IFRS 9. Note to the accounts does not provide clear classification of financial instruments into the categories specified by IFRS 9. Financial assets measured at amortised cost appears to include the VAT receivable – since this arises from a statutory rather than contractual arrangement it does not meet the definition of a financial instrument. Financial liabilities also seems to include balances described as ‘ taxation and social security’ – also statutory rather than contractual.	Yes – Updated in the final annual report and accounts

Misclassification and disclosure changes (continued)

Disclosure	Auditor recommendations	Adjusted?
Related parties	Note to be updated and expanded to include the balances or transactions with the subsidiaries and joint ventures and a note of the main entities within government with which the entity has had dealings although no details of transactions are required.	Yes – Related party disclosures updated
Remuneration and staff report	Sections of the remuneration and staff report that are audited are not clearly identified as being audited.	Yes – In final annual report and accounts
Group accounts	The accounts says Scottish Canals is not preparing group accounts partly because the ultimate/ immediate owner complies with IFRS. The Scottish Government as ultimate owner prepares accounts based on the FREM which although based on IFRS does not always comply with IFRS and therefore this exemption is not applicable.	Yes – Rationale for this exemption removed and clarified
Note 3 Restatement	Note 3 shows the restatement of operational assets as part of the PPA. IAS 8.17 requires that the initial application of a policy to revalue assets in accordance with IAS 16 Property, Plant and Equipment or IAS 38 Intangible Assets is a change in an accounting policy to be dealt with as a revaluation in accordance with IAS 16 or IAS 38, rather than in accordance with this Standard. If this is a change from cost to value it should not be part of the PPA therefore but included in the PPE note.	Yes – Updated in final annual report and accounts.
Investment property	Notes to the account report that the investment property is measured at fair value and that all are considered to be level three in the fair value hierarchy. The disclosure requirements of IFRS 13 : 93 have not been met for example the description of the valuation techniques and inputs is very high level and there is no quantitative information about the significant unobservable inputs used in the fair value measurement and no description of the sensitivity to changes in unobservable inputs.	No – Will be revised and enhanced in 2021/22

Misclassification and disclosure changes (continued)

Disclosure	Auditor recommendations	Adjusted?
Defined contribution scheme	IAS 19: 53 requires disclosure of amount recognised as expense for defined contribution plans – as part of the statement of accounts.	Yes
Disclosures in Accounting Policies	As we were reviewing the accounting policies we identified areas where the disclosure could be enhanced, to either a) further narrative to explain the policy, and its impact on Scottish Canals or b) to fully comply with FReM and the relevant standards. None were considered material to the user of the financial statements.	Partly. Will be picked up in the 2021/22 accounts around enhanced disclosures within accounting policies.
Tax disclosures	There is an opportunity for Canals to enhance disclosures in accordance with IAS 12: Income Tax to ensure corporation tax and deferred tax movements are appropriately reported.	No, will be build into the 2021/22 disclosures.
Financial Instruments	The disclosure of VAT in the prior year was included within the financial instrument disclosure note in error. The disclosure in 2021/22 is correct but differs from prior year. In normal circumstance this would have been a Prior Period Adjustment (PPA) in disclosures. However, recognising the disclaimer opinion, and that the disclosures this year are correct it has been determined to not be material to the users of these accounts, for the disclosure to be updated.	Yes.

2. Action plan and recommendations – Financial Statement audit

We have set out below, based on our audit work undertaken in 2020/21, the significant recommendations arising from our audit work:

Recommendation	Agreed management response
1. Accounting policies – Critical estimates and judgements and ability to supporting these estimates/judgements to auditors through the audit process The critical estimates and judgements accounting policy needs revisited by management in the 2021/22 annual report and accounts to ensure full compliance with IAS 1. Currently a number of estimates and judgements are disclosed which are either not estimates or do not meet the definition of critical judgements. This accounting policy should be clear, to the user of the accounts, what impact the judgement and estimate has had on the annual report and accounts, pin point the exact judgement and the rationale for that judgement, including why alternative judgements available have not been adopted. Lastly, to support the audit process, in respect of ISA 540 accounting estimates, management should be clear in the accounting estimates adopted, the rationale and be able to sufficient demonstrate to audit, with audit evidence, the judgements made and why.	Management response: The disclosures will be reviewed again as part of the year-end preparation in quarter four during the planning process in-house for the next year's set of accounts. Action owner: Director of Finance & Business Services Timescale for implementation: Quarter 4, 2021/22

2. Action plan and recommendations – Wider scope

Recommendation	Agreed management response
1. Capital Accounting – FAR During the course of our audit we identified a number of issues in respect of capital accounting, and the wider controls over property, plant and equipment (PPE), to inform the accounts. - The FAR needs to be reviewed to ensure for all assets captured, ownership (rights and obligations) by Scottish Canals can be evidenced and the description of the asset allows for ease of identification to support appropriate asset classification and then the subsequent accounting policies to be followed. - A full review to evidence the completeness and accuracy of the FAR including introducing suitable controls to assess impairment - An updated FAR, as noted above, to support year-end accounting considerations specifically around operational assets, including revaluation of operational assets and accounting through revaluation reserve, disposing of assets where assets are replaced; a process to assess enhancement or repair of existing assets, including if an asset is created, what type of asset is it, and then how can it be valued accordingly including a useful economic life being attributed, by someone independent of management. A clear policy on capitalisation, which sets a suitable threshold for subsequent capitalisation would also be beneficial. - A control to routinely confirm existence of assets.	Management response: Since the project and capital accountant began in November, the work on improving the existing finance fixed asset register, improving and broadcasting clarity on capitalisation policies and procedures across the organisation is now beginning. An action plan will be developed with clear milestones. This will include the improved fixed asset accounting, reviewing the controls around capitalisation of assets and improving the record-keeping for the capitalisation of projects. The existing land and buildings assets will be reconciled against the GIS and Estates' asset systems to ensure there are complete records, fully cross-referenced with a minimal risk of duplication. A programme of routine revaluation will be documented and scheduled, and a new routine impairment review process will now also now be put in place for the first time in order to provide assurance to audit that appropriate steps have been taken to ensure the asset valuations are reasonable. An assessment of the core assets considered to be of higher risk would be welcomed from external audit in order to reduce any reliance on judgement for material items in future years, and minimise the risk of any further limitation of scope. Action owner: Director of Finance and Business Services Timescale for implementation: ongoing – 24-month improvement programme

Recommendation	Agreed management response
2. Accounting treatment – Capital or revenue classification Based on our auditor judgement there are potential balances current classified as an asset, and capital in nature which are in fact revenue, and incurred in maintaining the canal network. This may have arisen by management incorrectly considering funding vs accounting, and that if funded via capital it needs to create a corresponding capital asset. A robust process needs to be established by management to justify and evidence the judgements made, where spend is capital in nature. In recognising this, management need to consider, if capital and does create a capital asset, under the FReM this needs to be subject to independent valuation. If it is difficult to identify the asset (type, component vs asset in its own right) then this difficulty will result in additional challenges on valuation, and management need to undertake this assessment with an accounting, valuation lens, alongside running the organisation. We acknowledge this will be a complex exercise. The valuation process, was commenced, to support the audit, but as we have set out in our report requires additional thought, and the need to balance with the time required to get correct vs managements requirements to submit audited annual report and accounts to be laid in parliament.	Management response: Scottish Canals does not believe that the source of funding, wither capital or revenue grant-in-aid has determined whether expenditure has been capitalised or put through revenue. There has been an established process of finance review before anything is capitalised, and this process has been subject to audit in prior years. However, it is accepted that a framework of policies and procedures and guidance to support the process is required, which will be part of the ongoing capital improvement programme. Furthermore, Scottish Canals produced comprehensive papers including justification for capitalisation, useful life analysis, photographic evidence, inspection reports and independent valuations of the operational assets in question. This work was conducted and provided in November. Scottish Canals would benefit from Grant Thornton specifically providing robust challenge on the specific items in writing as it is unclear at the moment if some of this work was acceptable to Grant Thornton or not to enable the organisation to be clear on the full programme of work required. Action owner: Director of Finance & Business Services Timescale for implementation: Quarter 3, 2022/23

Recommendation	Agreed management response
3. FReM requirements – Valuation (non-Investment Properties) Management need to review the categorisation of assets currently identified as specialised-operational. In accordance with the FReM assets in this category need to be subject to independent valuation and held in the accounts as Depreciated Replacement Cost (DRC). In order to undertake a valuation, that meets the requirements of the FReM and the audit process, Scottish Canals need to revisit the following: - Valuation for the components, that make up the asset. The valuation exercise in 20/21 considered total cost of the asset and valued that, rather than recognise the number of components and whether they had different useful economic lives and whether they had the same categorisation. This links to the capital vs revenue action point. - A valuation programme which includes a physical inspection of the asset - Where available, consideration of modern equivalent value and available market comparable data that is available, depending on the asset type. From our review of the current asset listing, certain descriptions do look like comparable market data would be available. - Suitable experience of the valuer, recognising certain assets are specialist but for other assets including within the circa £50m balance, a RICS qualified specialist is required. For example assets described as public amenity land, land based assets etc.	The categorisation exercise for infrastructure works conducted in July/August will be revisited over the coming months, together with analysis of assets by component. As components have not routinely been recorded, this will take a large amount of investigative work, and so is unlikely to be completed until after the 2021/22 year-end. Where the original information is available and/or identification of the different components can be reasonably assessed, componentisation for key infrastructure assets as at 31 March 2021 will be identified, with items of land and buildings being separated out in order to ensure a RICS valuer is appointed for specifically identifiable land and buildings items. Additional third party independent review of this work will also be sought from Scottish Government, Transport Scotland and professional advisors in order to provide additional assurance around the judgements and estimates in this area. Action owner: Director of Finance and Business Services Timescale for implementation: Initial categorisation work to be completed by March 2022, with componentisation and valuations being not likely to be completed before June 2022 as this is a significant piece of work.

Recommendation	Agreed management response
4. Frequency of Board meetings As outlined in the annual report and accounts during the 2020/21 financial year the Board met 16 times. We recognise it was a difficult and unusual year due to the pandemic, for Canals, particularly as income was impacted. However, for 2021/22 onwards we would expect the Board to move back to a more normal governance programme for an NDPB. We would consider 8 Board meetings per annum to be proportionate to the scale of risk and size of Scottish Canals as an organisation. It is important that the Board remain focused on the strategy of the organisation and do not become too operational in focus and a substitute/addition to the management team, which is a risk with meeting this frequently. In addition, consideration needs to be given to the timing, recognising the management and administration time required to prepare good quality Board papers for submission and discussion, with sufficient time between meetings for Management to take agreed actions.	Management response: The Executive and Board will consider this recommendation and review this in line with best practice. Action owner: Chair & CEO Timescale for implementation: Quarter 1, 2022/23
5. Remuneration Committee Scottish Canals have an established Remuneration Committee. The committee met 6 times during the financial year. The reason for this frequency is the ongoing pay harmonisation review. However, we note the Chair of the Remuneration Committee is the Chair of the Board and the membership of the Committee comprises all Board Members. Therefore, this is an extension of the Board. It is recommended that this is reviewed during 2021/22 in line with good Remuneration Committee practice. In particular, we recommend fewer Board Members are members of the Committee, the Chair is not the Board Chair, and this would enhance governance and reporting of Remuneration Committee actions through to the Board, for sufficient Board oversight where appropriate.	Management response: The Executive and Board will consider this recommendation and review this in line with best practice. Action owner: Chair & CEO Timescale for implementation: Quarter 1, 2022/23
6. Deferred capital income – Conditions in contract to allow deferral of income in the accounts Under the FReM capital income can only be deferred into future years if it meets certain conditions. We would expect these conditions to be clearly set out in the funding agreement (or contract). This is a different accounting treatment than what was allowable as a public corporation, and was being correctly followed in prior year by Scottish Canals. In adopting the FReM, £37 million of previously deferred capital income has been adjusted to show the year of receipt, within the transition and the 20/21 accounts. Going forward, if Scottish Canals wish to defer the capital income, future grant funding arrangements and/or contracts, need to clearly set out the conditions for this deferral. To do this, there will need to be a greater interaction between the respective project teams and finance, to ensure income is correctly accounted for in the financial statements.	Management response: The Executive Team accepts this recommendation and will ensure new and future contracts meet the criteria as set out by FReM. Action owner: Director of Finance & Business Services Timescale for implementation: Immediate

Recommendation	Agreed management response
7. Audit Process and quality of the unaudited annual report and accounts We recognise the changes in the finance team at the start of the financial year, with the new Director and Head of Finance only in post after the year-end. With the transition to an NDPB there has been a need to re-consider and account for a number of technical matters differently, which have resulted in a number of adjustments to the prior year comparatives and in-year financial statement figures in the Annual Report & Accounts since the first draft was produced. These adjustments have mostly been based on the FReM transition and have been one-off adjustments, and for 2021/22 a detailed timetable for the production of the annual accounts should be produced considering any new technical reporting requirements at an earlier stage. Such audit adjustments should be reduced going forward.	Management response: The Executive Team accept this recommendation and will timetable additional work in-year in order to support the production of the Annual Report & Accounts for 2021/22. Action owner: Director of Finance & Business Services Timescale for implementation: February 2022

Recommendation	Agreed management response
8. Medium Term financial planning Now the 3 year corporate plan is in place and the annual business planning process, Management should look to produce at least a 3 to 5 year medium term financial strategy setting out various assumptions and scenarios to support medium to long term financial planning decisions including investments. It is recognised that this will need to informed by the final strategic direction of Scottish Canals, alongside results of investment in digital and decisions on customer offerings, including wider income opportunities.	Management response: The Executive Team accepts this recommendation and is commissioning some work to be completed by the end of the year by Ernst & Young on the financial results in order to inform the strategy for the more medium-term. A new Corporate Plan will also be produced for April 2023 which will be informed by this piece of work. Action owner: Director of Finance & Business Services Timescale for implementation: April 2023

Recommendation	Agreed management response
9. Future sustainability of Scottish Canals as an organisation From April 2020 Scottish Canals became an NDPB, compared with a Public Corporation. As a Public Corporation, whilst still being responsible for maintaining the canal network (Transport Act legislation), you also sought to generate additional income, over and above core funding (50% SG Grant-in-aid and 50% other income sources). This was done primarily through investment property acquisition and development of land for regeneration and then subsequent sale. In the last two years, in particular, Scottish Canals has required additional funding to support the maintenance of the canal and repair canal breaches. In 2020/21 this was circa £20million. In considering the long-term financial sustainability of the organisation, and the organisations core purpose further work is required on the business model and ultimately how the Government are going to fund Scottish Canals in the future. There needs to be consideration of the investment/commercial activities, and how these continue to support Scottish Canals in the core objective of maintenance or whether these activities change, to solely focus on maintenance. Recognising the Canal is an ageing asset, the strategy and business plan needs to articular how funding will be best used by the organisation, and whether this is sufficient for Canals to meet its statutory obligations. Projects Scottish Canals delivered previously, which contribute to regeneration or public benefit (less attributed to statutory obligations as currently written) may need to be re-evaluated in the context of the increasing additional money required to fund canal failures, and to prevent future failure.	Management response: The Scottish Canals' Framework Document has not changed any of the core responsibilities of the organisation. Core funding comes from grant-in-aid and up to £3.5m income from destinations each year. There is less reliance on property income than on destinations income. The Executive Team has contracted Ernst & Young to produce a rigorous analysis of commercial income within the categories of: • Destinations • Estates and properties • Moorings • Regeneration • Waterways • Flagship Capital Projects Work is underway to complete a historic analysis of financial data, and establish a model on which future assessment of income streams can be reliably based. This will feed into the development of a medium-term financial strategy for the organisation. A detailed Asset Management Plan is already produced each year by the Chief Operating Officer to show the core infrastructure works required to reduce the risk of asset failures and will continue to be produced each year. Action owner: Director of Finance & Business Services Timescale for implementation: EY Project - March 2022; Medium-term Financial Strategy – March 2023

3. Follow up of 2019/20 recommendations

We set out below our follow up of our 2019/20 recommendations:

Investment Property recommendation: Under the Accounts Direction and IAS 40: Investment Property, Scottish Canals are required to recognise Investment property at fair value and therefore subject to annual valuation. During 2019/20 there were a number of Investment Properties not subject to formal revaluation in year. While we are satisfied that their fair value would not materially differ from carrying value, all investment properties should be subject to annual valuation.

Management Response: Scottish Canals changed its property valuations specialists this year and through this process 2 boats were omitted by the external evaluator. Scottish Canals have made arrangements for these to be reviewed during the Mid-Year assessment. We have already spoken with the valuations team to ensure this does not occur in future years.

Follow up: CLOSED. We note that in this years Investment Property valuation, Gerald Eve have valued the boats that were previous omitted in error. We note further action, within the 2020/21 audit around completeness of FAR records. An exercise needs to take place, to ensure that finance are able to reconcile the GE Investment property valuation to the FAR and understand any discrepancies.

IFRS 16 Leases: There are also assets where Scottish Canals retains ownership as overarching lease owner. The adoption of IFRS 16 could have significant impact on Scottish Canals. During 2019/20 we reviewed some of the preliminary work undertaken by Scottish Canals over lease arrangements. Management recognise that further work is required over the coming year to cover all lease and lease type arrangements. It is important that a comprehensive review of lease arrangements is undertaken to ensure Scottish Canals is appropriately prepared for adoption of the new standard.

Management response: IFRS will be part of our 2020/21 year end preparations, which are due to commence in October 2020.

Follow up: ONGOING. The implementation of IFRS 16 by all Scottish Government NDPBs was delayed by arrangement between Scottish Government and Audit Scotland due to Covid. This action remains outstanding and one that management will consider and plan for during 2021/22.

Financial capacity: In light of the financial and operational challenges facing the organisation, it is important that Scottish Canals has financial capacity, capability and leadership. Following the departure of the Finance Director in December 2019 and the Director of Estates in March 2020, Scottish Canals has strengthened through the appointment of a Director of Policy & governance and Director of Corporate Services. However, these are only temporary secondments from the Scottish Government and Scottish Police Authority and the organisation does not have a qualified accountant withing its Executive Management Team. While we recognise that there is regular financial reporting to the Executive Leadership Team, there is an opportunity to enhance qualified accounting experience within the organisation. Scottish Canals has commenced a recruitment exercise for EMT members including senior finance personnel. It is important that appropriate resource is in place to provide effective financial leadership and capability to meet the challenges faced in the coming years.

Management Response: The Board have considered the Executive Team structure and approved permanent recruitment on the 23/7/20. The Executive Team have also reviewed the Finance team capabilities and capacity and recruitment for key roles will commence in July 2020.

Follow up: CLOSED. The Executive team structure was reviewed and approved. A new Director of Finance and Corporate Services and a Director of People were recruited during the 2020/21 financial year. In addition a new Head of Finance commenced employment in June 2021, to support the finance team capacity.

Transparency in Investment decisions: As Scottish Canals matures as an organisation, and in the context of the new Corporate Plan, the organisation has recognised the importance of developing an overall framework for monitoring and reviewing strategic investments the extent theses delivery planned investment outcomes. As the development of the new framework is underway, it is important that Scottish Canals look to ensure this supports clear alignment between investment decisions and monitoring the delivery of planned outcomes and the extent to which the investment represented value for money.

Management response: An internal review is underway with regards to governance boards and reporting. This recommendation forms part of this and will be incorporated in to his work.

Follow up: SUPERCEEDED. This recommendation has been superseded by our 2020/21 recommendations.

New accounting framework as an NDPB (FReM): From 1 April 2020, the organisation will follow the accounting and financial reporting requirements of other NDPBs. The new Accounts Direction effective from 1 April 2020 requires Scottish Canals to prepare accounts under the FReM. The adoption of the FReM will have significant implications on Scottish Canals financial reporting and financial planning arrangements. While we recognise that the initial budgeting for 2020/21 was based on the FReM, and that plans are in place to prepare for the transition, there is still a significant amount of work required for the Scottish Canals to identify, assess and report on the impact of the transition to the FReM to ensure that Scottish Canals will be in a position to produce FReM compliant financial statements, and comparators, in 2020/21

Management Response: Scottish Canals have already transitioned to the new reporting standards, including updating the reporting and financial planning methods. Continued preparation and delivery of this recommendation has formed part of our 2020/21 governance requirements and year end preparations.

Follow up: CLOSED. The 2020/21 annual reports and accounts have been prepared under FReM and the necessary opening balances adjusted. However, we have identified areas for improvement, in terms of disclosures and these are captured in the 2020/21 action plan.

National Fraud Initiative: In 2019/20, Scottish Canals participated in the National Fraud Initiative (NFI). 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 ensured submission of NFI data in accordance with reporting timescales. However, Management recognise that there are opportunities to improve the investigation of NFI matches and ensuring these are appropriately closed on a timely manner in the NFI database

Management response: Scottish Canals recognise the importance of this and the opportunity to build continuous improvement in to the delivery of this initiative & piece of work

Follow up: CLOSED . Scottish Canals have completed the NFI exercise, including timely investigation and reporting of matches.

4. Audit fees and independence

External Audit Fee

Service	Fees £
External Auditor Remuneration	45,490*
Pooled costs	7,130
Contribution to Audit Scotland costs	1,580
Contribution to Performance Audit and Best Value	Nil
2020/21 Fee	54,660

*Fees for other services

Service	Fees £
We confirm that for 2020/21 we did not receive any fees for non-audit services.	Nil
We undertake individual grant audit inspections for EU Grant funding for Scottish Canals. In 2020/21 we audited one claim.	1,200

*Audit fee overruns

Due to the technical complexities arising over the audit of PPE, the additional, more senior audit time needed and the additional audit resource required over and above forecast in the plan we have incurred a fee overrun. We are discussing this fee overrun and will agree that with the Accountable Officer. [To be agreed]

Fees for other services

As noted opposite we have undertaken an EU Grant claim certification in-year for Scottish Canals. We have specifically considered our threats to independence, in undertaking this grant work, and the safeguards we are applying. We have concluded:

- The fee of £1,200 is significantly lower than the audit fee, reducing potential or perceived risk on self-interest.
- The expenditure incurred by Scottish Canals, from the EU is significantly lower than Scottish Canals total expenditure, reducing self-interest threat.
- Our work is certifying what Scottish Canals claim from the EU is supported by underlying records. Our work is based on the test programme set by the EU. Any decisions made by the EU on Scottish Canals future funding is made solely by the EU.

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 Financial Reporting Council'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 Financial Reporting Council's Ethical Standard 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 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.

Client service

We take our client service seriously and continuously seek your feedback on our external audit service. Should you feel our service falls short of expected standards please contact Joanne Brown, Head of Public Sector Assurance Scotland in the first instance who oversees our portfolio of Audit Scotland work (joanne.e.brown@uk.gt.com). Alternatively, should you wish to raise your concerns further please contact Jon Roberts, Partner and Head of Assurance, 30 Finsbury Square, London, EC2A 1AG. If your feedback relates to audit quality and we have not successfully resolved your concerns, your concerns should be reported to Elaine Boyd, Assistant Director, Audit Scotland Quality and Appointments in accordance with the Audit Scotland audit quality complaints process.

Transparency

Grant Thornton publishes an annual Transparency Report, which sets out details of the action we have taken over the past year to improve audit quality as well as the results of internal and external quality inspections. For more details see Transparency report 2020 (grantthornton.co.uk)

5. Communication of audit matters

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 below.

Our communication plan	Audit Plan	Annual Report to Board and AGS
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		•

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