Grant Thornton

External Audit Report for Scottish Canals

Financial year ended 31 March 2022

Prepared for the Board of Scottish Canals and the Auditor General for Scotland

Final Report May 2023

Contents

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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 2022 for Scottish Canals. The scope of our audit was set out in our External Audit Plan which was presented to the Audit and Risk Committee in May 2022.

The main elements of our audit work in 2021/22 have been:

- An audit of Scottish Canals annual report and accounts for the financial year ended 31 March 2022; and
- 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.

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

This report is addressed to the Board of Scottish Canals 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 an 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 Scottish Canals promote improved standards of governance, better management and decision making, and more effective use of resources.

Specifically in our audit recommendations we have focused on the controls we believe Scottish Canals should establish over its recording and accounting of property, plant and equipment assets, in particular the specialist operational assets. This includes future looking controls required to ensure completeness and accuracy of underlying records, and the evidence required to support the audit process including valuation judgements and estimates.

Audit of the annual report and accounts

Key messages and judgements

We issued a disclaimer audit report for 2021/22 (disclaimer opinion in prior year, 2020-21). This is in respect of the material complex and significant judgements over the valuation of PPE and underlying PPE records.

We have identified a significant number of adjusted and unadjusted audit misstatements through the audit process. In addition a number of significant disclosure corrections identified during our audit are included in Appendix 1. No matters of significance were identified out with our audit testing of PPE.

We have also raised a series of recommendations for management (financial statements and wider scope) as a result of our audit work in Appendix 2 and Appendix 3.

Our follow up of recommendations from the prior year's audit are detailed in Appendix 4.

Our audit opinion

For the financial year ended 31 March 2022 we issued a disclaimer opinion on the annual report and accounts. As reported in the independent auditor's report, we are unable to conclude that the annual report and accounts give a true and fair view and that expenditure and income were incurred in accordance with the applicable enactments and guidance. In doing so, we are unable to conclude that the annual report and accounts are free from material misstatement, in respect of the highly material property, plant and equipment balances in the Statement of Financial Position, recognising a key strategic objective of Scottish Canals is to maintain the Canal network. On this basis we have concluded it is both material and pervasive to the financial statements in determining a disclaimer opinion.

This is set out in the opinion, within the annual report and accounts and is supported by enhanced narrative, within this external audit annual report.

The audit process

As agreed with management we selected our samples for audit in July 2022 based on the trial balance submitted by Management for audit. Our substantive audit work commenced, in full, in October 2022 after we re-priortised our external audit portfolio, delaying the start of the Scottish Canals audit by one month. We received the first version of unaudited accounts for audit in January 2023. This timing recognised the extensive work on the canals valuation and that the full accounts could not be provided until this exercise was concluded. These unaudited accounts did not include tax, leases, the cash flow statement and the statement of tax payers equity. Given the time period, the unaudited accounts not being available until later and multiple changes processed by Scottish Canals between the first trial balance and the final version, this has proved difficult to audit and reconcile, back to the accounts. This is evidenced in Appendix 1 (adjustments).

To be flexible, recognising the complexity of the work and subsequent accounting, for specialised-operational assets we agreed we would start our audit testing on balances not impacted by the valuation. We selected PPE balances, for audit testing, from the valuation reports. We did not get supporting working papers from management for other PPE balances (non-valuation) until January 2023. In many cases it was difficult to tie all the balances through, between working papers, trial balances and disclosures in the accounts. Due to time, capacity, and valuation complexity a final fixed asset register (FAR) showing all in-year movements was unable to be produced.

Overall the quality of the working papers provided alongside suitable audit evidence to support balances in the financial statements was not of the standard we would expect. This led to significant additional time being required for audit, where audit evidence submitted to the audit team was sent back as insufficient and/or incomplete.

Audit of the annual report and accounts

Audit process (continued)

We recognise that the turnover in the finance team alongside, the size of the finance team did impact on the annual accounts and audit process, alongside significant work on the valuation. However, it is recommended that management work with the new auditors closely over the requirements of audit, and are more readily able to support the audit process through good quality, self-reviewed, complete and accurate working papers. This extends beyond PPE, to other material areas of the accounts.

Audit of property, plant and equipment (PPE)

A key change in the accounts for 2021/22 relates to property, plant and equipment. Management engaged consultants to perform a reconstruction of the FAR closing balances, and a revaluation of the specialised assets. This was a complex exercise and has led to a highly significant increase in the value of property, plant and equipment recognised in the accounts, and a restatement of the prior year.

We reviewed the process of reconstructing the FAR closing balances, which was based substantially on the entity's engineering records and aimed to ensure that the accounts reflected a complete record of the entity's assets for the first time. We were satisfied that the approach appeared to be reasonable in terms of creating a model of the entity's assets. However, in the course of our testing we identified a significant number of errors in the accounts, and other areas where we have been unable to obtain sufficient appropriate evidence to conclude that the PPE balance and movements in the PPE note are not materially misstated. A challenge was the nature of the records retained by Scottish Canals, in particular for project spend, and what has been retained to evidence costs.

We were unable to obtain sufficient assurance over the valuation of PPE (£354million) due to not being able to obtain sufficient audit evidence to conclude that the estimate is reasonable. The nature of the valuation was highly specialised and complex, and comparable data is limited due to the specialist and historic nature of the majority of the assets. A number of the valuations which we tested were substantially based on cost data provided by management (either estimated or based on historic project costs or legacy FAR data) which we were unable to corroborate further. The total value of these items within our sample was £169.3million. Additionally we were unable to obtain sufficient assurance over the assumptions relating to residual values for assets where the valuation reflected a residual value equating to 12 years remaining utility (£129.8million, a subpopulation of the total of £354million). This assumption is highly sensitive – if a 10 year residual life (as suggested as potentially appropriate by our auditor expert based on the limited information available) was used instead then we estimate that the carrying value would reduce by £21.6million. For both of these issues, these represent areas where we have been unable to obtain sufficient audit evidence over the balances included in the accounts, rather than reflecting confirmed misstatements in the financial statements.

Audit of the annual report and accounts

Audit of property, plant and equipment (PPE) (continued)

- We were unable to obtain sufficient assurance relating to additions to PPE in year (£33.8million), based on our sample test. 7 items totalling £1.3million appear to relate to 2020/21 rather than 2021/22 (some appear to be duplicated as also included in prior year additions); 2 items totalling £83,000 are revenue costs rather than capital based on the evidence provided; 8 items totalling £468,000 do not have sufficient evidence to confirm whether they are revenue or capital in nature. The total value of these items is £1.8million, and the projected (estimated) risk of misstatement is £6.4million. Some of these misstatements may be presentational in nature within the PPE note, while others may impact the SOCNE, however we are unable to quantify the potential adjustments.
- We were unable to obtain sufficient assurance over the 'transfers' (£8.5million), which reflects movements out of assets under construction (AUC) into operational asset categories.
- We identified a number of errors relating to AUC(£51.7million) in the course of our sample test. 5 items tested became operational before year end based on the evidence viewed, while 2 did not have sufficient evidence to confirm either way. The total value of these items is £7.8million. However, when assets become operational, they should be revalued, and therefore we are unable to quantify the potential impact on carrying value. Additionally, we did not obtain sufficient assurance over the carrying value and ownership of assets under construction due to the issues identified in our testing of additions, and the fact that we do not have assurance over the prior year additions.
- We were unable to obtain sufficient assurance regarding rights and obligations over PPE assets. This was due to our sample test identifying 1 item (£100,000) which Scottish Canals do not own, and 1 item (£97,000) where we were unable to view sufficient appropriate evidence. In addition, for one item Management agreed they did not have ownership of the asset, and this was removed from the accounts (see Appendix 1).
- Due to the extent of the issues encountered through our testing of the 2021/22 figures, we have not tested the restated figures. We therefore do not have sufficient assurance over opening balances and as a result have been unable to obtain sufficient assurance over in-year movements which rely on opening balances, namely depreciation charges for the year (£5.9million) and revaluation movements (£17.2million).

Further details on our work on valuations and the FAR reconstruction are included in the relevant sections of our report, while the impact of the errors and other issues identified is summarised in Appendix 1. We have also included a number of recommendations in Appendix 2.

Audit of the annual report and accounts

Audit of property, plant and equipment (PPE) (continued)

Work can be done by Scottish Canals to improve the wider control environment over PPE. This will include transferring all the PPE records into the FAR, including the output from the consultants valuation, as there is currently an increased risk of manual error.

Whilst we do recognise the significant effort and progress Scottish Canals have made in year, in respect of the asset categorisation, componentisation of assets and the valuation there remains, due to the complexity and availability of third party data (including relevant Canals data), significant judgements and estimates where we are unable to quantify the material impact on the financial statements.

Therefore, whilst there has been an improvement in records this year, we have concluded, in our disclaimer opinion, that there are still insufficient records to support material PPE balances within the accounts.

Audit of the annual report and accounts

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 and subsequently submitted to Audit Scotland.

Subsequent to our audit plan, Scottish Canals determined that the Canals and associated Canal assets would be in effect recorded on the Balance Sheet, valued in accordance with the FReM criteria. This resulted in net book assets of £460 million compared to prior year (circa £100million). As a result, we reviewed the appropriateness of the materiality benchmarks (set, in the plan, using a % of total expenditure). We are required to consider materiality, from the perspective of the users of the financial statements. The principal purpose of Scottish Canals is to maintain the canals and the canal network. Therefore, we determined the users would be interested in what value of assets Scottish Canals hold and how they use those assets. Secondly, they would be interested in how Scottish Canals spend their money, maintaining and delivering a service, using these assets.

Therefore, we revised materiality to:

- 1% of the unaudited total assets disclosed. This equates to £4.4million as our overall materiality.
- We set a performance materiality of £2.8million which equates to 65% of overall materiality. This was deemed appropriate in the context of the prior year disclaimer opinion and the level of errors identified and reported.
- We set a specific lower materiality of £0.532million on the Statement of Comprehensive Income and Expenditure. This was calculated using 1.7% of unaudited total expenditure. This lower materiality was applied to ensure sufficient testing of the Income and Expenditure Statement.
- We set trivial as £220,000 for the Statement of Financial Position (5% of overall materiality) and £26,600 (5% of the specific lower materiality).
- A specific materiality of £25,000 on the Remuneration Report (Senior Management and Board Members salaries and benefits) recognising this is a disclosure of interest, which is material by nature.

In accordance with the ISA requirements, we have reviewed our materiality levels on concluding our audit. We conclude this is still appropriate and we have undertaken sufficient audit testing, to be able to conclude on the audit, noting the disclaimer audit report.

Audit of the annual report and accounts

Internal control environment

In accordance with ISA requirements, we have developed an understanding of Scottish Canals control environment. Our audit is not controls based and we have not placed reliance on controls operating effectively as our audit is substantive in nature however, we have assessed the design and implementation of key controls in relation to significant risk areas.

We identified no material weaknesses or areas of concern from this work which would have caused us to alter the planned substantive approach as documented in our plan.

However, we did identify a lack of controls in respect of PPE, and these have been reported within this report. In addition, going forward, management will need to review the internal controls in respect of the FAR and underlying asset records, as well as existence of assets, and key controls over the FAR (completeness and accuracy) in our to support the account balances.

Responding to significant financial statement risks

Significant risks are defined by the International Standard on Auditing (UK) (ISAs) 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.

Risks identified in our Audit Plan	Commentary

Management override of controls
 	
As set out in ISA 240 there is a presumed risk that management override of controls is present in all entities. 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, where management override could be possible and/or more susceptible to override.
 	
In addition, we specifically consider the existence of revenue during the financial year (non-Grant-in-Aid from Scottish Government) 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 2022 and retrospective review of those estimates as at 31 March 2021.
	• 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. We did not identify any indication of fraud or inappropriate management bias in accounting estimates that could result in a material misstatement. We have raised an improvement recommendation in respect of journals in the Action plan, noting many journals appear to have been incorrectly posted, in error, and corrections required.
	The annual report and accounts include an accounting policy on management judgements and critical estimates. The current disclosures could be further improved, to demonstrate full compliance with the FReM. For example: not all that is currently included 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 users of the accounts in understanding the impact. See Action Plan.

Risks identified in our Audit Plan

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 for all entities. Scottish Canals is primarily funded by the Scottish Government through Grant-in-Aid ("GIA"). GIA is received throughout the year and is accounted for as financing on a cash basis, not as income, and in accordance with the FReM is credited to the "General Fund" reserves in the Statement of Taxpayers' Equity. Whilst material, we consider this funding to be well forecast and it can be directly agreed to Scottish Government funding reducing the opportunity for manipulation and the inherent risk of material misstatement. As such, we rebut the risk of fraud in revenue in relation to GIA.

Scottish Canals recognised £718,000 of grant income (in relation to the Job Retention Scheme) and £655,000 of third party funding in revenue in 2020/21. Again, whilst material, we consider grant income and third party funding easily agreed to funding and award letters, reducing the opportunity for manipulation and the inherent risk of material misstatement. As such, we rebut the risk of fraud in revenue in relation to grant income and third party funding.

Scottish Canals generates other revenue through a range of sources including the sale of goods (water, utility and retail sales) and rendering services (including capital grant release). 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 includes a specific focus on year end cut-off arrangements, where it may be advantageous for management to manipulate year end revenue results.

Commentary

In response to this significant risk, our audit response was as follows:

- Performed walkthroughs of the controls and procedures in place over Revenue (non-Scottish Grant-in-Aid);
- Evaluate your revenue recognition accounting policy for appropriateness and compliance with HM Treasury's Government Financial Reporting Manual (the "FREM);
- Perform detail testing of revenue transactions at and around year end to verify the accounting period transactions relate to and confirm that transactions have been recognised in the correct financial period; and
- Review the judgements and estimates made by management when recognising accrued and deferred income at year end within the financial statements and challenge management accordingly.
- Tested material debtor balances 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 material exceptions in relation to the occurrence or completeness of revenue recognised by Scottish Canals during 2021/22. No exceptions were identified as a result of focused testing performed in relation to the risk of cut-off and transactions recorded in the correct period.

We have gained assurance in relation to the recoverability of year end debtor balances and are satisfied that these balances have been recorded accurately.

We agreed with Management an enhancement to the revenue recognition accounting policy, recording Scottish Canals policy on recording receipt of income in the financial ledger.

Risks identified in our Audit Plan	Commentary
Risk of fraud in expenditure recognition As set out in Practice Note 10 (revised) which applies to public sector entities, we consider there to be an inherent risk of fraud or error in expenditure recognition. Scottish Canals' 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 focus our risk on the following non-payroll expenditure streams: Materials, maintenance and repairs and Other costs. Our testing will include a specific focus on year end cut-off arrangements, where it may be advantageous for management to manipulate year end expenditure results.	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; • Evaluate your expenditure recognition accounting policy for appropriateness and compliance with the FREM; • Perform detail testing of expenditure transactions at and around year end to verify the accounting period transactions relate to and confirm that transactions have been recognised in the correct financial period; • Review the judgements and estimates made by management when recognising accruals and provisions at year end within the financial statements and where appropriate challenge management accordingly. • Unrecorded liability testing to confirm the completeness of year-end liabilities and expenditure recognised during the year. **Conclusion** Through our audit procedures performed, we did not identify any material 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. Similar to the point in Accounting Policies on Income recognition, the Accounting Policy was updated, to enhance the policy for accounting for expenditure.

Risks identified in our Audit Plan	Commentary
IAS 19 Defined Pension Liability – Valuation risk 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 schemes' assets and liabilities in the Statement of Financial Position. As at 31 March 2021 Scottish Canals had pension fund liabilities of £1.2 million. 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. We focus this risk on the appropriateness and reasonableness of the underlying assumptions adopted by the actuary and suitability of these for Scottish Canals.	In response to this significant risk, our audit response was as follows: • perform walkthroughs of the controls and procedures over the valuation of defined benefit pension liabilities, including management's oversight of the valuation; • consider the work of the actuary for Strathclyde Pension Fund (Hymans Robertson UK LLP), including the assumptions applied, using work performed by PwC (commissioned on behalf of Audit Scotland to review actuarial assumptions proposed by LGPS actuaries); • consider 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 (noting the Waterways Pension Fund was just below our materiality level); • seek 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 to and requested a response from Audit Scotland as the external auditor of Strathclyde Pension Fund. • perform substantive analytical procedures over the pension fund movements, investigating any significant deviations from audit expectation; • review the accounting entries and disclosures made within Scottish Canals' financial statements in relation to IAS 19; and • evaluate 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 identified one potential exception in our review and testing over the IAS 19 defined benefit pension liabilities recognised in the financial statements. This arose due to unadjusted misstatements totalling £88.244 million from the audit of Strathclyde Pension Fund due to an unaccounted increase in the value of level 3 investments. However, Scottish Canal's share of the pension assets total is only 0.02% so we determined this unadjusted error in the Pension Fund accounts would be immaterial to Scottish Canal's accounts. Through considering the work performed by PwC, we are satisfied that the assumptions applied by the actuary are reasonable. The IAS 19 defined benefit liability decreased from £1.2 million in 2020/21 to £0.262million in 2021/22. In the immediate aftermath of Russia's invasion on Ukraine, there was a significant fall in the Fund's asset values. However, over the remainder of March 2022, the Fund's assets have broadly recovered to similar levels to those of prior year.

Risks identified in our Audit Plan	Commentary
Valuation of Investment Property In accordance with the HM Treasury's Government Financial Reporting Manual (FReM), subsequent to initial recognition, Scottish Canals is required to hold investment property at fair value and must subsequently revalue these assets at each balance sheet date. At 31 March 2021, Scottish Canals held £24.3 million of investment property including land and buildings let at open market rents, land and buildings held for capital appreciation and moorings. Scottish Canals engage valuation expert Gerald Eve to determine an appropriate valuation for these investment properties, with valuations being based on a number of key assumptions including an estimate of future rental income associated with these properties. Given the value of investment property held by Scottish Canals and the level of complexity and judgement in the estimation valuations, we have recognised a significant risk in relation to the valuation of investment property at 31 March 2022. We focus this risk on the appropriateness and reasonableness of the underlying rental yield assumptions used by Scottish Canals.	In response to this significant risk, our audit response was as follows: • review of revaluations made during the year, confirming valuations have been input correctly into the asset register; • Understanding the basis on which valuations are carried out and challenge the information and assumptions used in the valuation process, particularly in relation to rental yields used; • Evaluation of the competence, capability and objectivity of Scottish Canals' professional valuer of operational specialist assets who represent management's experts under ISA 500; and • engaging our own valuations expert to assess the instructions issued by Scottish Canals to their valuers, the final valuers' report and the assumptions used that underpin the final valuations. **Conclusion** We note in 2021/22 as part of the wider valuation, Management considered if any assets previously classified as Investment Property, in effect, no longer met this criteria and would be transferred into another asset category. Where this was the case, specific testing was not undertaken in relation to the transfers however, this was considered within our valuation of PPE and within the resultant valuation. These assets were transferred to PPE as they were no longer held to generate income or for capital appreciation. We were unable to validate the entry into the FAR, as this was not done at the point of audit, with manual records, and the valuation report provided. However, we did agree the asset value, to the independent report, to the trial balance, with minor differences identified. Within our sample we identified 2 assets (linked, on the same site) which were valued at a rental yield but were in fact unoccupied. Correspondence with the valuer confirmed the valuation would not be materially different. We noted that the Dundas Hill asset swap, resulting in the sale of Dundas Hill and the purchase of 2 sites, by Scottish Canals, from BIGG Partnership, was valued by CBRE. We considered CBRE as a management expert, and liaised with them, over the valuation. See commentary in the wider scope section of our report over the asset swap arrangements.

Risks identified in our Audit Plan	Commentary
Valuation of operational specialised assets, freehold land and buildings In accordance with the HM Treasury's Government Financial Reporting Manual (FReM), subsequent to initial recognition, Scottish Canals is required to hold property, plant and equipment on a valuation basis. The exact valuation basis depends on the nature and use of the assets. Specialised land, buildings, equipment, installations and fittings are held at depreciated replacement costs, as a proxy for fair value. Non-specialised land and buildings, such as offices, are held at fair value. There are further modifications to values depending on the nature and use of assets to ensure PPE is approximately stated. As at 31 March 2021, Scottish Canals held PPE of £105.1 million including operational infrastructure, freehold land and buildings of £58.5 million. Given the value of operational specialist assets, freehold land and buildings held by Scottish Canals and the level of complexity and judgement in the estimation valuations, there is an inherent risk of material misstatement in these assets. Scottish Canals will appoint independent expert valuers to undertake a rolling programme of valuations across the assets base, valuing operational infrastructure, freehold land and buildings at a minimum of once every five years. [*note the narrative above was per the audit plan, based on prior year balances]	**Our testing in relation to operational specialist assets included:** • Walkthroughs of the controls and procedures over the valuation of operational, specialist assets; • Consideration of the arrangements in place at Scottish Canals for ensuring completeness and accuracy of operational specialist assets recorded in the Fixed Asset Register; • Review of component revaluations made during the year, confirming valuations have been input correctly into the fixed asset register and accounted for correctly in the financial statements; • Evaluation of the competence, capability and objectivity of Scottish Canals' professional valuer of operational specialist assets who represent management's experts under ISA 500, and consideration of the experience of the valuer, recognising these assets are specialist in nature (e.g. the Canal itself) but other assets such as public amenity land and land based assets require a valuation by a RICS qualified specialist; • Review of component useful economic lives and residual values and whether they are appropriate given the nature of the component; • Performing focused testing in relation to management's impairment assessment, particularly in relation to assets which have not been subject to a formal valuation during the year, and consider the appropriateness of the assumptions used as part of this assessment. (continued)

Risks identified in our Audit Plan	Commentary
Valuation of operational infrastructure, freehold land and buildings (Continued)	Our testing in relation to freehold land and buildings included: • Walkthroughs of the controls and procedures over the valuation of land and buildings; • Consideration of the arrangements in place at Scottish Canals for ensuring completeness and accuracy of the land and buildings recorded in the Fixed Asset Register; • Evaluation of the competence, capability and objectivity of Scottish Canals' professional valuer of land and buildings who represent management's experts under ISA 500; • Confirming the completeness and accuracy of underlying information provided by Scottish Canals and used by their expert valuer in arriving at the valuation of land and buildings as at 31 March 2022; • Challenging the appropriateness of the assumptions adopted by the valuer in valuing land and buildings; • Performing focused testing in relation to management's impairment assessment, particularly in relation to assets which have not been subject to a formal valuation during the year, and consider the appropriateness of the assumptions used as part of this assessment; and • Using 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 2022. Conclusion There was a significant change to the valuation approach for 2021/22 compared to previous years, with a significant proportion of operational assets (including the canals themselves) being valued for the first time, resulting in a significant increase in the value of assets recognised in the accounts and a prior period adjustment. Management engaged consultants to perform a reconstruction of the fixed asset register based on a range of data sources including Scottish Canals' underlying engineering records, and this was then used as the basis of the assets to be revalued. The existing valuer Gerald Eve was also used to value a number of assets classified as operational real estate. Our testing of valuations covers the work of both valuers via a sample test. Note, that whilst the consultants performed a reconstruction of the FAR this was for the purpose of determining the assets to be subject to valuation. The consultants were not contracted to provide Scottish Canals with a fully constituted FAR, as part of their work. Further details of our review of key data and assumptions used in the valuation are set out in the significant estimates and judgement section of this report. *(continued overleaf)*

Risks identified in our Audit Plan	Commentary
Valuation of operational infrastructure, freehold land and buildings (Continued)	In the course of our work, we have provided challenges to management and their valuers over a number of elements of the valuations. This included the sufficiency of evidence used to estimate replacement costs for some assets, and key assumptions including those relating to obsolescence, useful lives and residual values. We were unable to obtain sufficient assurance over the valuation of PPE (£354million). A number of the valuations which we tested were substantially based on cost data provided by management (either estimated or based on historic project costs or FAR data) which we were unable to corroborate further. The total value of these items within our sample was £169.3million, and the projected (estimated) risk of misstatement is £194.8million. Additionally we were unable to obtain sufficient assurance over the assumptions relating to residual values for assets where the valuation reflected a residual value equating to 12 years remaining utility (£129.8million, a subpopulation of the total of £354million). Note that these do not reflect 'errors' or confirmed misstatements but are rather areas where we have been unable to obtain sufficient assurance. See further comment within the opinion section upfront, for details which have resulted in the conclusion of a disclaimer of audit opinion.

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).

During the course of the audit, our procedures undertaken included:

- 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 2021/22 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 in relation to the valuation of PPE assets, in particular Investment Properties and operational assets, as at 31 March 2022. Our audit procedures are documented within our response to the significant risk of management override of controls.

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

- 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.
  - 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 the following significant accounting estimates and judgements impacting on the annual accounts:

Significant judgement or estimate	Summary of management's approach	Audit Comments	Assessment
Property, Plant and Equipment Valuations (£354m)	In accordance with FReM requirements and, Scottish Canal's portfolio of property, plant and equipment assets have been subject to valuation. Scottish Canals have appointed external valuers who are RICS qualified who have undertaken and reported on the valuation of these assets. The valuer has conducted the valuation in accordance with the FReM and RICS guidance and the valuation movements are reflected in the accounts. Management engaged Gerald Eve to value the operational real estate assets as in previous years. Management also engaged consultants to value the entity's operational non-real estate assets for the first time. This has resulted in a significant increase in the value of the assets on the balance sheet. These assets are specialist and have therefore been valued at depreciated replacement cost (DRC). (continued)	This estimate was significant in value and the majority of the estimate was new in year. We have therefore carried out a significant level of testing to obtain assurance over the estimate. We have: • Assessed the work of management's experts • Considered the completeness and accuracy of underlying source data used to determine the estimate • Reviewed and challenged key assumptions used • Considered the adequacy of the disclosures relating to the estimate in the financial statements. Based on the work performed, we were unable to obtain sufficient assurance over the valuation of PPE or the related valuations movements in the accounts. (continued)	Insufficient evidence to conclude

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 estimates and judgements

Scottish Canals financial statements include the following significant accounting estimates and judgements impacting on the annual accounts:

Significant judgement or estimate	Summary of management's approach	Audit Comments	Assessment
Property, Plant and Equipment Valuations (continued)	Valuations of specialist assets were carried out on a category basis with broadly the same valuation approach taken for assets within each category (for example, aqueducts, reservoirs, and different categories of bridge). Key assumptions used in the valuation included useful lives and residual values. A range of assumptions were also used in determining an estimate of gross replacement cost for each category. We understand that management engaged in discussions with their valuers to discuss the approach taken and to agree on the key assumptions used, with input from Scottish Canals engineers. The highest value category of specialist assets is that for the canal lengths, which reflects the valuation of the canals (excluding Helix which was valued based on historic cost), with a total valuation at 31 March 2022 of £137.1million. The gross replacement cost of the canal lengths was substantially based on length data from the engineering system, multiplied by estimates made by management for a replacement cost per metre for key components (e.g. minor embankment, major embankment). The total gross replacement cost estimate was then (continued)	For a number of the valuations which we tested we were unable to obtain sufficient assurance due to these being substantially based on Scottish Canal's internal system information or being estimates made by management for which supporting documentation has not been provided. In terms of Scottish Canals internal system information, this is a mix of the historic FAR costs, or capital project data. Overall we consider this could be a reasonable source of cost data. However we have been unable to verify whether these costs would be genuine reflections of the replacement cost for a similar asset, or whether they reflect either lower costs (due to being additional spend on existing assets rather than full construction/acquisition costs) or higher costs (due to being wider projects that include spend on more than simply the component being valued). The total value of these items within our sample was £169.3million. This includes the canal lengths category of £137.1million for which management have not provided any underlying calculations or evidence to support the costs per metre used in the valuation. A key assumption in the valuation of specialist assets relates to useful lives and residual values. We (continued)	Insufficient evidence to conclude

Significant estimates and judgements

Scottish Canals financial statements include the following significant accounting estimates and judgements impacting on the annual accounts:

Significant judgement or estimate	Summary of management's approach	Audit Comments	Assessment
Property, Plant and Equipment Valuations (continued)	apportioned over the various components that made up the overall canal length. The useful lives for canal lengths were assessed as 120 years, but given the age of the network the majority of the canal length was valued on the basis of a 10% residual value, effectively an estimated remaining utility of 12 years. Sections with recent significant spend were valued based on the remaining estimated useful life. As part of the work on reconstructing the FAR, a number of assets previously treated as investment properties were reclassified to operational PPE as it was deemed that these did not meet the definition of investment property under the FReM. This resulted in a prior period adjustment. Additionally assets with a carrying value of £10.9m have been carried at net book value rather than being revalued. Following our audit queries, management has provided additional justification of the approach taken and the reasons for certain assets not being subject to valuation.	understand that these were determined in discussion between management, Scottish Canals engineers and the consultants, including consideration of benchmarking. We have not been provided with any detailed minutes supporting these discussions, or analysis supporting the figures chosen (other than the benchmarking), and the engineers involved have subsequently left Scottish Canals. As a significant number of the assets were deemed to be >200 years old, and therefore over the useful life set, a residual value was also incorporated into the valuation. This was designed to reflect the fact that these assets were still in operational use and therefore operating beyond UEL while still being maintained. These residual values effectively reflect an estimate of remaining utility between 1 and 12 years depending on the asset class. We utilised our own engineering expert to assist us with reviewing the useful lives and residual values used, although this was limited to general commentary due to the lack of underlying data supporting the lives selected. We were unable to obtain sufficient assurance over the assumptions relating to residual values for assets where the valuation reflected a residual value equating to 12 years remaining utility (continued)	Insufficient evidence to conclude

Significant estimates and judgements

Scottish Canals financial statements include the following significant accounting estimates and judgements impacting on the annual accounts:

Significant judgement or estimate	Summary of management's approach	Audit Comments	Assessment
Property, Plant and Equipment Valuations (continued)	(See previous pages)	to 12 years remaining utility (£129.8m, a subpopulation of the total of £354m). £116.7million of this £129.8m relates to the canal lengths category. We also performed a review of assets not revalued and challenged management about why they were not valued. From review, these include low value, low life assets which appear reasonable not to be revalued. However, asset 5029 Bowling viaduct access (Bowline) is held at depreciated historic cost with NBV £4.7m (historic cost £4.9m), rather than being valued at depreciated replacement cost. We challenged management as to why DHC was deemed appropriate for a large value asset but were not satisfied with their justification. From review, there does not appear to be a material risk however we recommend that management consider including this asset in the valuation in future years.	Insufficient evidence to conclude

Significant judgement or estimate	Summary of management's approach	Audit Comments	Assessment
Investment Property Valuations	In accordance with FReM requirements and IAS 40 and IFRS 13, Scottish Canal's portfolio of investment property assets have been subject to an annual valuation. Scottish Canals have appointed external valuers who are RICS qualified who has undertaken and reported on the valuation of these assets. The valuer has conducted the valuation in accordance with the FReM and RICS guidance and the valuation movements are reflected in the accounts.	We are satisfied that the approach adopted by Scottish Canals is reasonable in producing the investment property valuation and there is no indication of management bias in the approach adopted. Management obtained independent valuations of these assets as at 31 March 2022. The assumptions appear reasonable and any deviation from our expectation has been suitably explained.	● Light purple
Pension and Other Post-Retirement Benefits	Scottish Canals engage Hymans Robertson UK LLP (Strathclyde Pension Fund) and Lane Clark & Peacock LLP (British Waterways) to provide annual IAS 19 actuarial valuations of Scottish Canals' net liabilities in the pension scheme. There are a number of assumptions contained within the valuation including: discount rate; future return on scheme assets; mortality rates and future salary projections. These key assumptions are discussed with the actuary to inform the report. These are predominantly informed by the actuaries recommended assumptions. The Head of Finance reviews the draft actuarial valuation to ensure appropriate and any significant movements or unusual entries are discussed with the actuaries.	As noted in our response to significant risk section, using the work of PwC, we reviewed the key assumptions underpinning the actuarial valuation. We are satisfied that the assumptions adopted were appropriate for Scottish Canals 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 found that management have disclosed the key sensitivities surrounding are reported in the annual report and accounts, as required per the 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.	● Light purple

Significant judgement or estimate	Summary of management's approach	Audit Comments	Assessment
VAT Liability	In 20/21, Scottish Canals recognised a VAT liability of £8,896k which arose due to a claim from HMRC relating to previous VAT treatment and what did or didn't constitute as a VAT exempt activity. During 2021/22, Scottish Canals made payments of £4,150k to HMRC, which in part was provided for via capital funding provided by the Scottish Government (£2,400k). The outstanding balance of £15,546k at 31 March 2022 sits under Long Term Liabilities within the annual report and accounts. Management have determined this is the correct accounting treatment given negotiations continue and the review has not yet been concluded by HMRC.	We have reviewed the correspondence between Scottish Canals and HMRC with the liability calculated based on advice received and correspondence with HMRC and taking into consideration payments made in-year towards to balance. We have considered the most up to date position on the VAT liability (as at April 2023)	● Light purple
Investments	Scottish Canals do no prepare group accounts. The joint venture/associate equity accounting method has been prepared, in accordance with the FReM. Investments in joint ventures are disclosed within the SoCNE and within the relevant notes to the annual report and accounts.	We have reviewed the Scottish Canal's group reporting structure alongside management's own assessment of control. We have confirmed the accounting is correct, in accordance with the FReM and that group accounts are not required. However, we have raised a recommendation for Management to review this, in 2022/23 to consider whether this judgement remains appropriate.	Not applicable
Taxation	Scottish Canals accounts disclose taxation with the tax computation undertaken by Scottish Canals tax advisors.	We have reviewed the tax computation prepared by KPMG and agreed to the underlying disclosures within the financial statements. We note the tax computation was undertaken on an earlier version of the financial statements and an update may be required on the final version. This may impact the tax balance however, our disclaimer opinion, does not form an opinion on the tax disclosed.	● Light purple

Significant estimates and judgements (continued)

As set out in our Audit Plan, to ensure compliance with ISA 540 revised we also requested further information from management in relation to the following estimates (which have not been considered significant by management as described above):

- Evidence used to assessment impairment within Trade Receivables

We would consider this an area of application of accounting policy rather than areas of judgement in applying accounting policies. IAS 1 requires disclosure of significant estimates where there is a risk these could materially change over the next 12 months. Whilst the financial statements cover those areas of critical judgement and estimation, there is an opportunity to enhance disclosures made in accordance with IAS 1. This includes providing the reader clarity around the key assumptions and areas of estimation that could result in a material change in the coming period and sensitivities around these. In addition, the note should disclose where judgement has been made in applying accounting policy (not included within estimates). See Appendix 2.

Other key matters arising during the year

As part of our audit there were other key matters arising during our audit. Whilst not considered a significant risk, these are areas of focus for our audit:

Issue	Commentary
Reconstruction of fixed asset register (FAR)	Management engaged a consultant to perform a reconstruction of the FAR closing balances. This was based on a range of data sources including Scottish Canals' underlying engineering records, with the aim of providing a complete model of the assets held by Scottish Canals. Preliminary work (including categorisation of assets from the AMX system) was also commissioned from another consulting services firm. As part of our audit we: • gained an understanding of the process carried out to reconstruct the FAR • performed high level reconciliations to gain some assurance over the integrity of the reconstruction • tested a sample of items which were included in the original data sources but excluded from the final FAR (this included de minimus items and duplicates) • obtained management's assessment of the de minimus policy applied to gain assurance that there is not a risk of material misstatement Based on our work, we were satisfied that the process to reconstruct the closing balances appears reasonable. The consultant FAR reconstruction provided balances as at 1 April 2020, 31 March 2021 and 31 March 2022, but did not include in-year movements. Due to time pressures, management have not updated their own FAR system with the new consultants FAR data, although a reconciliation between the two was performed which identified a small number of errors. This meant that accounting movements (including revaluations entries, depreciation and so on) have been manually calculated, which increases the risk of error. We raised a number of queries due to not being able to agree the figures in the draft accounts to underlying working papers, or not being provided with asset-by-asset breakdowns supporting the figures in the accounts. Management subsequently performed a more detailed review and made a number of adjustments to the accounts. We have raised a control recommendation related to this in Appendix 2. Our detailed testing identified a significant number of other issues including errors in the disclosure of additions and transfers out of AUC, and an unexplained difference between the accounts and the consultants FAR output of £749,000 which we have reported as an unadjusted misstatement in the absence of evidence to the contrary. The reconstruction of the FAR also resulted in a significant prior period adjustment. Due to the extent of the issues encountered through our testing of the 2021/22 figures, we have not tested the restated figures.

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 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 and agreed a number of disclosure enhancements (see Appendix 2). These can be further enhanced in 2022/23. We confirm these are aligned to prior year, with the exception of valuation of property, plant and equipment and in accordance with the FReM.
Matters in relation to related parties	We are not aware of any related parties or related party transactions which have not been disclosed. However, the related party transactions disclosure note does not meet the requirements of IAS 8 in full (see recommendations)
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. In light of the disclaimer opinion, we are unable to provide this assurance, where the narrative in the unaudited accounts references PPE balances.

Other key elements of the financial statements (continued)

Issue	Commentary
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 FReM and are satisfied that these have been properly prepared in accordance with applicable legislation.
Governance report	The Governance Report is set out on pages 29 to 38 of the Annual Report and Accounts. The report sets out how Scottish Canals has been governed during 2021/22, including Scottish Canals Board and Audit and Risk Committee arrangements 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: financial management; financial sustainability; governance and transparency; and, value for money, we have considered the arrangements in place at Scottish Canals for securing and evidencing Best Value. 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. As in prior year, with the disclaimer opinion we are unable to conclude that Scottish Canals has retained adequate accounting records and we confirm we have not received all the information and explanations we require for audit purposes.

Issue	Commentary
Written representations	A letter of representation will be requested from Scottish Canals, which will be included in the Board papers and signed by management.
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.
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. We are unable to conclude on this, in the context of a disclaimer opinion, which was similar to prior year.

Wider Scope reporting

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. We take a risk based audit approach, utilising our cumulative audit knowledge of Scottish Canals and understanding of its risks and priorities.

Wider scope dimension	Wider scope risk within 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	Significant risk identified: Scottish Canals have had in recent years an increase in capital funding. A capital accountant has been employed on a fixed term contract and they will support the review of the Fixed asset register.	Finance team – Turnover and capacity The narrative in the front end of the annual report and accounts notes that in 2021/22 Scottish Canals staff turnover was circa 20%. Scottish Canals, like other public sector organisations, continue to face challenges in recruiting into finance, particularly into more senior roles. During 2021/22 there has continued to be a number of leavers within the finance team. This includes the Head of Finance, who joined Scottish Canals 16 months ago, leaving in February 2023. There is limited knowledge of Canals now within the finance team, and this did impact on the audit process as well as the running of the finance function during the year. As a short-term measure, an interim Head of Finance was recruited (December 2022 to February 2023), but this arrangement was ended, as not considered a suitable solution. In addition, the Head of Finance role, at time of writing, is being re-advertised after the preferred candidate subsequently withdrew from the process. A fixed term individual, appointed into the capital accountant role, subsequently also left the organisation, replaced with a permanent project accountant who joined Scottish Canals in November 2022. Wider than finance team, Scottish Canals should look further to understand what underpins the high attrition rate (linked to recent staff satisfaction survey feedback], and what positive action, Canals can take to retain the staff they have, and better look to succession plan, for key posts.	Scottish Canals need to address the gaps in the finance team to ensure the finance team is sufficiently skilled and has capacity, to support the audit, alongside supporting the organisation. Scottish Canals need to consider what skills are required, to create and maintain the FAR, and whether this is a full-time capital accountant or a dedicated role, within the finance team. Without this, the controls necessary will not be sufficiently implemented. Scottish Canals should review the staff survey results and seek to understand the high attrition rate and what action needs to be taken, linking this to the workforce plan that is being developed. See Action plan recommendations.

Wider scope dimension	Wider scope risk within audit plan	Wider scope audit response and findings	External Audit conclusion
Financial Management Continued	Significant risk identified: Continued	Capital Accounting and capital funding Scottish Canals continue to be reliant on capital funding from Scottish Government. Core capital funding (excluding additional in-year requests) has increased from a low base of £3.5million in 2018/19 to £12.2 million in 2022/23. The capital funding supports the maintenance of the canal network, which is priortised on a risk based approach, and in accordance with the Canals asset strategy. Out with this programme, any one off incidents are typically funded in addition to the core financial budget, by Scottish Government. Whether this is sustainable given the age of the canal network (as now more evident, with the inclusion of the Canal as an asset, on the Balance sheet) remains to be seen in the medium to longer term.	Based on the capital funding, the age of the asset, in the context of the Asset Strategy, Scottish Canals continue to priortise funding, based on their risk assessment. Overall insufficient funding is in place, to maintain the network to a consistent standard. In the event of asset failure, Scottish Canals may still continue to be reliant on one-off funding, to rectify the failure/repair the Canal network.

Wider scope dimension	Wider scope risk within audit plan	Wider scope audit response and findings	External Audit conclusion
Financial Management Continued	Significant risk identified: HR Job evaluation (pay and reward review) will result in increased costs to Scottish Canals	HR Job evaluation – Pay and reward review In 2019, Scottish Canals initiated an HR job evaluation pay and reward review. This has taken a significant period of time for the organisation due to the need for collaborative working with trade unions, grading of all roles, design of a new pay structure and associated terms and conditions and ongoing consultation and approvals. The project was delayed during Covid-19 and restarted in quarter four of 2020/21. The aim of the review is ensure the grading is fair, equitable and implements transparency over pay and bringing pay back in alignment with the wider public sector, across the NDPB portfolio. No additional costs are accrued for, or provided for in the 2021/22 annual report and accounts. Our understanding on discussion with management is that any likely backdating of pay, will only apply from 1 April 2022 once the pay deal is settled between Scottish Canals and the Trade Unions. The overall impact of the interim pay award for 2022/23 was £0.134million, with the final pay award expected to be around £0.300 million dependant on ongoing Trade Union negotiations. A disclosure post balance sheet event note has been added to the 2021/22 annual report and accounts, as a non-material, non-adjusting, disclosure event only.	The pay and reward review concluded in March 2023. The costs, and interim pay award, will be subject to external audit in 2022/23. We understand in 2022/23 this resulted in an additional £236,000 of payroll costs. The ongoing future costs have, we understand, been built in future financial forecasts. Overall pay costs for Scottish Canals, as disclosed in the 2021/22 accounts, were higher, than core revenue in-aid funding received from Scottish Government. This is a high cost base, and should be reflected in the medium to longer term financial plan, and workforce planning. See recommendations in the Action plan.

Wider scope dimension	Wider scope risk within 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 Scottish Canals is planning effectively to continue to deliver its services or the way in which they should be delivered.	Significant risk identified: Scottish Canals had an overspend of £1.2 million in 2020/21. There is a risk that Scottish Canals in the medium to longer-term is not financially sustainable without reducing costs and reviewing its operating model. The 2020/21 financial statements disclosed a VAT liability of £8.9million.	Financial Performance in 2021/22 In year, Scottish Canals received grant-in-aid of £9.7million with additional money for Covid relief of £0.66 million. Income from commercial activities was £7.8million. Contributing to the income was retail sales of £2.6 million for visitors to the Falkirk wheel and Caledonian Canal Centre. These have not yet fully recovered to pre-Covid levels but increased significantly from 2020/21 when income was £0.78 million. Other key sources of income include property rental (£1.9 million); water and utility sales (£1.4 million); third party funding for maintenance of towpaths (£2.1 million). Other operating charges in-year has increased significantly from £10.8 million in the prior year to £19.2 million. £10.8 million of this increase is attributable to additional expenditure on the VAT liability in-year. Staff costs represent 102% of the grant-in-aid funding received from Scottish Government. Capital funding received was £12.2 million. In addition, £2.4 million of capital money was made available to support the VAT liability, as additional capital money was available centrally within Scottish Government, unspent. Capital money was used across many projects in-year including replacing lock gates, upgrades to embankments, dredging, sheet pilling, and upgrades to reservoirs. Scottish Canals net operating expenditure was £16.81 million which reduced to £16.32 million after tax and other finance items. This resulted in comprehensive net expenditure for the year of £1.77 million, which was largely due to the gain on the revaluation reserve.	

Wider scope dimension	Wider scope risk within audit plan	Wider scope audit response and findings	External Audit conclusion
Financial sustainability Continued	Significant risk identified: Continued	Budget 2022/23 Scottish Canals Board approved the 2022/23 budget in March 2022. Grant-in-aid from Scottish Government of £10.5million (Revenue) and in addition £12.2million in capital funding. In addition, in order to cover Scottish Canals operating costs, they are dependent on partnership funding and the generation of income, out with Scottish Government. The 2022/23 budget highlighted risks to the financial sustainability of Scottish Canals: - The outcome of the HMRC VAT review and the longer-term consequence on the financial position of when and when not Scottish Canals can re-claim VAT, depending on what is classified as a core business activity of Scottish Canals - Ongoing work with advisors on the Scottish Canals income strategy and performance across the income portfolio, to take forward an investment strategy - The additional cost and work associated with valuing the Canals assets (as reported elsewhere in this report) The budget paper noted that expenditure has remained broadly consistent year on year. However, costs are expected to increase in the context of rising inflation, impacting particularly on fuel, utilities and insurance costs. The 2022/23 budget included an estimated £0.4million for the job evaluation, that was due to conclude in year and would include an estimated back-date to 1 April 2022	In the context of a revised corporate plan, Scottish Canals should continue to plan to produce a medium to longer term financial plan. This should take into account the rising cost profile, revised pay arrangements, risks with income generated out with Scottish Government funding, and within the plan clearly set out how Scottish Canals is financially sustainable, in the future. This will need to include the impact of any changes to Scottish Canals VAT status. The conclusion of the income work, we expect will also inform this financial strategy.

Wider scope dimension	Wider scope risk within audit plan	Wider scope audit response and findings	External Audit conclusion
Financial sustainability Continued	Significant risk identified: Continued.	**Medium term financial strategy** A medium-term financial strategy overview paper was presented to the EMT and Transport Scotland in January 2023. Key points noted on review: - A recognition that Scottish Government has increased capital funding to Scottish Canals year on year, from £3.5m in 2018/19 to £12.2million in 2021/22. However, climate change is impacting on the Canals and more recently construction inflation, which is running at over 20% has resulted in the backlog maintenance reported in 2018 of £74m, to in excess of £100m in 2022. - The cost of job evaluation has been included alongside annual pay increases, including pay protection in 2023/24 and 2024/25. This sees staff costs of £10.9 million in 2022/23 rising to £12.3 million by 2026/27. - The opportunity to grow the Scottish Canals income generating portfolio within the parameters of the Scottish Canals governance framework and in line with the SPFM requirements. Money from income generating projects can be re-invested in Scottish Canals in the future, including supporting the core canal running costs in future years. There is a risk, due to the longer-term impact of Covid and any UK wide economic recession that the value of investments fall or planned asset sales do not achieve the forecast income expected. **Asset Management planning** Scottish Canals set a twelve-year asset management strategy in 2018. This is supported by asset management plans the most recent covering the period 2021 to 2024. The plan, devised by Scottish Canals engineers covers the condition and performance of the existing infrastructure assets, the activities to meet or sustain the current level of service and to address current or future shortfalls and consider areas to further improve asset management governance. Work is priortised according to avoiding a catastrophic asset failure, staff and visitor safety and functionality of the canals.	

Wider scope dimension	Wider scope risk within audit plan	Wider scope audit response and findings	External Audit conclusion
Financial sustainability	Significant risk identified:	Consultancy By adding the canal network to Scottish Canals accounts, Scottish Canals incurred spend not forecast (in the original budget) of £0.500 million with the consultants who worked on the valuation. This was in addition to a spend of £23,200 with an additional consultant who supported on the fixed asset register, and asset componentisation. There is expected to be an ongoing future cost, for Scottish Canals, of working with the consultant on the valuation of the asset base. Scottish Canals have set aside £100,000 for the valuation in 2022/23. It is intended that this will allow the consultant to fully hand over, the model (or detailed assumptions) so that beyond 2022/23, Scottish Canals can further test the market, for an external valuer, to demonstrate assessment of value for money. Aside from the valuation, Scottish Canals also spent circa £1.2 million on consultancy spend, in 2021/22 and 22/23. This includes work on reviewing the Scottish Canals income strategy and VAT and tax advisors.	Scottish Canals have invested significantly in the valuation of specialised operational assets and will have an ongoing commitment to the consultants to complete annual valuations. See recommendation in the Action plan, on assessing value for money and how Scottish Canals in the future, can ensure ongoing value for money, including potential alternative valuer options, being available, to allow Canals to benchmark services.

Wider scope dimension	Wider scope risk within audit plan	Wider scope audit response and findings	External Audit conclusion
Financial sustainability	Significant risk identified: VAT Liability	VAT Position As highlighted in the 2020/21 audit, Scottish Canals have an ongoing historic VAT liability which, alongside VAT advisors, they have been challenging with HMRC. This VAT liability dates back to 2017/18, and year on year has been increasing. The dispute relates to what constitutes a viable business expensive, by Scottish Canals for the purposes of reclaiming VAT. An accrual was in the 2020/21 accounts, alongside a payment to HMRC towards the outstanding liability, paid by Scottish Canals without prejudice. An increase in that accrual is disclosed in the 2021/22 accounts, with a further payment made. The 2021/22 accounts, as at 31 March 2021 set out a VAT liability of £15.68 million with £315,000 of default interest. We understand, given the time period, this value, continued to increase in 2022/23. In the spring budget revision, funding was provided by Scottish Government to fund the full VAT liability due to HMRC as forecast at March 2023. At the time of concluding our audit, Scottish Canals had requested a further, internal review by HMRC. This is due to conclude end of May 2023, after HMRC delayed the anticipated review period of January 2023 and subsequent March 2023. The anticipated total amount owed to HMRC is £23.732 million. Scottish Government, via the Sponsor Team have confirmed to Scottish Canals that any ongoing VAT considerations, including changes to VAT exemption rates, Scottish Canals will need to fund through their ongoing grant-in-aid budget and no further income will be available.	The outcome of the VAT decision by HMRC could impact on the ability of Scottish Canals to recover VAT to the extent it has in the past. This will need built into future financial plans and it is noted that additional funding will not be received from Scottish Government to fund the ongoing costs to Scottish Canals.

Wider scope dimension	Wider scope risk within 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:** Arrangements within Scottish Canals to maintain good governance during the year including governance and transparency. Plans in place within Scottish Canals to recruit a new chief executive (current arrangement due to end March 2023).	**Governance arrangements** During 2021/22 the Board chair's term ended and a new Chair was appointed. During the year the remit of the Remuneration committee and its membership has been reviewed, with the creation of a People Committee in its place. As recorded in the annual report the Board met 12 times during 2021/22. In addition, the Audit and Risk Committee met more frequently than the planned four, recognising the disclaimer audit report in prior year and the significance of adding on the Canals as an asset, and its underlying value, into the financial statements. As reported in our 2020/21 Annual Report there is a risk that the Board becomes too operational, and there is no need for the Board to meet in effect monthly. We note in 2023/24 there is a plan to reduce this to 6 meetings with 4 development sessions. Again, we would encourage the Board to review whether this is required, and the nature and need for the development sessions, out with formal Board meetings. [see follow up of 2020/21 external audit recommendations in Appendix 4] **Chief Executive** Scottish Canals Chief Executive left the organisation in December 2022. The Chief Executive was on a five year contract with Scottish Canals which was due to run to March 2023. A recruitment process was commenced in October 2022 to recruit a permanent replacement. In the interim, the Chief Operating Officer has stepped into the interim Chief Executive/Accountable Officer role. The appointment of a new Chief Executive was announced in March 2023, with their employment commencing in the later part of May 2023.	As reported, we note the aim to reduce Board meetings to 4 a year, and consider how many sub-committees are required, during the year to support the Board. Potentially 4 development sessions, in addition to formal Board meetings, is disproportionate to the size of Scottish Canals but this is a matter for the Board to determine. The effectiveness of these arrangements will continue to be considered by external audit in future years.

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:** The Asset swap in 2021/22 with its Joint Venture partner and how Scottish Canals evaluated value for money in this transaction.	**Asset Swap – Dundas Hill** During 2021/22, Scottish Canals sold two Dundas Hill plots to BIGG Regeneration, Scottish Canal's Joint Venture Partner (49% interest). In return for the sale, Scottish Canals purchased two Investment Properties, from BIGG. The asset swap concluded during July 2021 and the accounting entries for the transactions were reviewed and confirmed to be appropriate. CBRE were the Valuers, who under took the valuation on behalf of Scottish Canals. It was noted, that CBRE were the established Valuer for BIGG, valuing these properties for BIGG. We could not obtain evidence over how Scottish Canals ensured themselves of the independence of CBRE in undertaking a valuation on their behalf, which was identified as a conflict of interest by CBRE.	There is an opportunity to re-review the strategy for the remaining Dundas Hill plots of land, including the valuation basis (depending on use/planned nature). If Scottish Canals in the future, are undertaking asset sales/swaps with its joint venture partners, the valuer appointed should be further considered and Scottish Canals satisfied of their independence.
		Workforce planning Scottish Canals has in 2021/22 experienced high levels of staff turnover and difficulty recruiting. At the time of the budget paper, management were reporting 40 unfilled posts, which was in comparison with the historic establishment, for the organisation. The historic nature, of the organisational structure, will be reviewed, with only vacancies required, in the revised structures taken forward, and filled. In addition, as noted Scottish Canals has now concluded on a pay review. This commenced initially in 2018/19, but was subject to delays due to Covid. Overall, organisational turnover has impacted on Scottish Canals through the creation of additional pressure on delivery and created inefficiencies.	Scottish Canals should look to produce a clear workforce plan, which supports the Corporate plan and the annual business plan. We understand this is planned for 2023/24 [see Action plan]. This is particularly important for Scottish Canals as the workforce model, as currently stands, is also dependent on seasonal and casual workers.

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.	Continued	Partnership working and strategic direction Scottish Canals work with a number of partners. This includes the joint ventures they have established with BIGG regeneration and the Millenium Link Trust. In addition, they work with a number of partners on jointly funded capital projects, across the public and the private sector. Often these projects are joint funded or receive funding via partner organisations. As Scottish Canals looks ahead, they should ensure clarity over what assets are in the ownership of Canals, as a result of these joint funded projects (for the purposes of asset record keeping and valuation, as referenced in this report). They should also ensure that the projects are fully aligned to the purpose of Scottish Canals, bring benefit to the organisation, in the short and the longer term and that undertaking the project, is aligned to the strategy and the best use of Scottish Canals resources, in the delivery.	Linked to the corporate plan Scottish Canals should continue to review their partnership arrangements to ensure they represent value for money. Linked to this, a revised consideration of the control of these entities, and the FReM requirements to re-confirm that group accounts are not required.

Future PPE record keeping and valuation considerations

Following the inclusion of the Canals network, as in effect a networked asset, on the Scottish Canals balance sheet it is recognised that going forward this will require significant ongoing maintenance by management. In addition, the valuation requirements, as set out in FReM will need to be met. At the time of our audit, any revision in controls and the ongoing costs of maintenance not yet established.

Areas requiring consideration include:

- The importance of the accurate and timely recording in AMX (the project management system), and if this is the underlying data source feeding the FAR, a control, within Scottish Canals, which determines if an asset is created, and how that asset should be added/modified or derecognised from the FAR.
- The interface between AMX and the Fixed Asset register to match spend (where appropriate) to the correct component of asset
- A clear process to maintain a complete and accurate fixed asset register including recognition and accounting for assets under construction, additions and disposals.
- How on an annual basis the assets not subject to valuation will be assessed for impairment including consideration of ongoing maintenance and scheduled review of the assets, and the consideration of these assessments on how they impact on the carrying value of the asset.
- Maintaining evidence of ownership and existence of assets
- The policy for capitalising dredging and how this expenditure will be assigned to the relevant asset in the FAR, including derecognition and how this impacts on the value of the asset at year end, alongside useful economic life and residual value.
- Whether there is a need within the Finance team to recruit a permanent fixed asset accountant (or equivalent)

Specific to valuation, Scottish Canals will need to consider whether indices will be used, and if yes, the most appropriate indices, in between intervening valuation years, and whether to value all assets once in a five-year period or a rolling valuation programme. It is noted that the consultant as the Valuation expert (specialised operational assets) retain ownership of the valuation model. Therefore, it is assumed there will be an ongoing commitment to spend with the same consultant on an annual basis to support valuation. Scottish Canals will need to determine whether this represents value for money.

Without sufficient investment in controls and a valuation programme Scottish Canals will be unable to demonstrate, for audit purposes, how they comply with the FReM requirements. [See Action Plan]

Future organisational direction

Scottish Canals have appointed a new Chief Executive who joins the organisation in May 2023. The current corporate plan runs for the period 2020 to 2023, and to date that has been supported by an annual business plan. The annual report and accounts summarise the key objectives of Scottish Canals, which include, four strategic principles: Transforming our canals, creating new opportunities, excelling at what Scottish Canals do, and responding to global challenges. The annual business plan cross refers to the Scottish Government national outcomes, with a focus on post Covid green recovery.

From an external auditor perspective, from reviewing the corporate and annual plan and the associated media, issued by Scottish Canals there is a potential for a risk of mixed messages, around the purpose of the organisation. For example, the heritage, tourism, protecting public realm, heritage assets and how this relates to the recording of the canal and associated components as specialist operational assets, effectively like network assets. Linked with the requirements to maintain the canal network, for wider use, alongside as an organisation, to develop and work in partnership, to deliver projects and generate income, outside of the Scottish Government core funding.

At times, it is recognised this may result in competing priorities, for the organisation. How do Scottish Canals balance projects, and the time/resources required to deliver the project, alongside in effect the day job of ensuring they maintain the Canal network. Given now a non-departmental body, as opposed to a public corporation, there is an opportunity to clarify this, in the future Corporate plan.

The inclusion of the canals, as an asset, on the Balance sheet starkly highlights an ageing asset that needs investment, to maintain the asset, and the reality of an organisation which is in receipt of circa £9million revenue funding from Scottish Government per annum, with capital funding, of £12.2million per annum.

Currently, the additional income generated by Scottish Canals, will not be sufficient, to fund all the maintenance required, filling a gap, in the funding from Scottish Government. Scottish Canals has a high-cost base, in our view, which is not all covered, by core Grant-in-aid, currently, and this is before considering the additional costs of the public sector pay alignment and the impact, that future VAT recovery, will have on Scottish Canals activities. As covered, in our commentary on financial sustainability. Clarity over purpose and forward direction, will support the development of a medium to longer term financial strategy.

Linked to the wider strategic direction, will be the need for Scottish Canals to consider its income generation activities, as a result of Covid and the current economic climate recognising retail units/business space could potentially be less in demand, and that those organisations renting and paying money to Scottish Canals, may themselves no longer be financially viable and operating. There is also the consideration of post Brexit the rising construction costs and the impact this may have on the capital projects undertaken by Scottish Canals. This resulted in capital and revenue projects in 2022/23 being re-priortised, recognising higher costs and affordability.

The priority, suggested in the Framework Agreement, based on our review, is first and foremost within the legislation is the maintenance of the canals. Income generation, whilst referenced, appears to be a secondary aim/by-product of maintaining the Canal. An agreed future strategy, with Transport Scotland is needed to better guide Scottish Canals in its decision making, and support Scottish Canals become a more sustainable organisation.

Other areas of focus

In accordance with Audit Scotland Planning Guidance, as part of our audit work in 2021/22 we consider Scottish Canals arrangements for equality and fairness as well as considering the risk of fraud in procurement. We did not identify any significant wider scope audit risks in these areas. Utilising Audit Scotland's Best Value guidance we considered the arrangements at Scottish Canals.

Risk of fraud in procurement

In accordance with Audit Scotland's planning guidance, we considered the risk of fraud and corruption within the procurement function. Through our audit procedures performed, we have not identified any significant risks or deficiencies in relation to Scottish Canals arrangements over fraud and corruption within procurement.

Scottish Canals, is a stand-alone public body and its procurement activity is governed by Public Procurement Regulations. Scottish Canals have created a number of internal documents to help promote good procurement practice across the organisation. These documents meet the requirements of the Procurement Reform (Scotland) Act 2014. The Procurement Strategy document explains the strategic aims of the procurement function of the organisation, while the Procurement Policy document gives more detail on the steps that will be carried out to help deliver the Strategy. An annual report is produced to show a summary of regulated procurement that has taken place as well as a list of the anticipated procurement activity that is likely to be carried out.

Additionally, Scottish Canals advertise contract opportunities on Public Contracts Scotland (a site provided by the Scottish Government) and is designed to allow a consistent approach to advertising contract opportunities across the public sector in Scotland. The site gives details of past, current and future tender activity of Scottish Canals as well as providing access to the Contract Register (which details contracts including name of supplier, period of contract, award date and value).

In order to reduce the costs in both time and materials, Scottish Canals have adopted electronic tendering using the Scottish Government portal PCS-Tender. This site is used by a number of Public Sector Bodies in Scotland and allows the entire tender process to be carried out electronically. Where possible, Scottish Canals look to utilise collaborative contracts where they offer a saving in terms of cost or efficiency. Collaborative contracts are set up as national, local or sectoral contracts that bring together organisations with common procurement needs.

Scottish Canals participate in National Fraud Initiative (NFI). During 2021/22, there were no instances of fraud identified during the year.

We note that internal audit have included in their work programme a review of Scottish Canal's procurement arrangements. This was deferred by management in 2022/23 due to other priorities but is within the Internal Audit programme for 2023/24 alongside a planned public sector procurement review in January 2024.

Equality and fairness

In accordance with Audit Scotland's Code of Audit Practice and Audit Scotland Planning Guidance, as part of our 2021/22 external audit we considered the Fairness and Equality characteristics and the arrangements in place at Scottish Canals.

At the time of the audit, Scottish Canal's Equality policies were under review and have not yet been adopted and as such, we were unable to review equality and fairness arrangements in detail at Scottish Canals.

However, we noted within the Scottish Canals 2020-23 Corporate Plan, as part of their third priority, 'excel in what we do', in ensuring Scottish Canals excels in governance and financial resilience best practice, demonstrates an agile approach, the organisation have set out several objectives around equality and fairness including:

- Continue to tackle social-economic imbalances and inequality in communities, on the canals and in workplaces, to ensure that all groups and communities are represented.
- Further enhance the approach to driving continuous improvement through evaluation of planning processes, rewarding success and ensuring Scottish Canals is a great place to work.
- Deliver the required obligations under the Public Sector Equality Duty in respect of equality, diversity and human rights.

We have not identified any further risks or significant deficiencies in relation to equality and fairness arrangements within Scottish Canals.

Climate change

Climate change is a fundamental part of Scottish Canals' work. In response to Scotland's climate change target to reach net zero emissions of all greenhouse gases by 2045, Scottish Canals commissioned the preparation of a Net Zero Strategy and Action Plan due for completion in 2022/23. This work will set targets for reducing direct emissions, engage staff and other stakeholders and outline how the organisation can work in partnership with communities and other stakeholders as part of a just energy transition. Complementing this new approach to sustainability is Scottish Canals' Environment Strategy, which is now in its seventh year, and sets out how sustainable benefits will be delivered from across a range of environmental themes in the period 2015-25 for stakeholders, customers, the canal network and the wider environment.

Scottish Canals reports its carbon footprint in fulfilment of their duty under the Climate Change (Duties of Public Bodies: Reporting Requirements) (Scotland) Order 2015. The organisation's 2021/22 carbon footprint was reported as 1,207 tonnes carbon dioxide (CO2) equivalent. This represents a 14% reduction compared to their baseline year of 2013/14. The reduction is primarily attributed to decarbonisation of the electricity grid over the period. In November 2021 at the UN Climate Change Conference (COP26), Scottish Canals hosted an event and officially launched Europe's first and only Smart Canal in North Glasgow in the conference's Climate Ambition Zone.

Scottish Canals Corporate Plan 2020-23 includes a fourth priority 'responding to global challenges: Scottish Canals understands how it can mitigate and adapt to climate change risks'. In 2022/23, Scottish Canals will outline the definable actions which can be taken to addressing climate change resilience in terms of their own estate and the potential impacts on the communities in which they operate. During the reporting year, the organisation piloted the installation of rooftop solar panels and associated air source heat pumps on the Falkirk Wheel visitor centre, and also installed an air source heat pump in Old Basin House which will house a non-profit community organisation and food space. Scottish Canals are also working in partnership to develop third party renewable energy projects to benefit the communities they serve e.g. Fort William 2040 project to provide hydro power for a district heating system and have also participated in the Zero Waste Scotland's (ZWS) Public Sector Benchmarking project which will contribute to creating Energy and Water benchmarks for Scotland's Public Sector buildings.

Within the 2021/22 annual report and accounts, Scottish Canals have laid out their arrangements around climate change within the Environmental Sustainability section. Furthermore, throughout 2021/22, Scottish Canals held several meetings with local authorities to develop partnerships to mitigate flood risk and deliver climate adaption measures.

Climate change is an area which external audit will continue to consider and report on, during the 2022/23 external audit.

Appendices

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.

ADJUSTED MISSTATEMENTS

The table below provides details of adjustments identified during the 2021/22 audit which have been made within the financial statements.

Detail	Statement of Comprehensive Net Expenditure £000's	Statement of Financial Position £000's	Statement of Changes in Taxpayers' Equity £000's
Being adjustment to release deferred capital income receipts: Dr Deferred Income Cr Other Operational Income	 (4,117)	 4,117	 0
Being release of project deferred income: Dr Deferred Income (less than 1 year) Cr Income from Commercial Activities	 (143)	 143	 0
Being correction to accrued income for over-accrual: Dr Income from Commercial Activities Cr Accrued Income	 35	 (35)	 0
Being adjustment to correct the in-year deferred capital income movement in relation to NGIWMS: *Dr Other Operational Income* Cr Deferred Income (less than 1 year)	 23	 (23)	 0
Being reclassification of the other payable balance: *Dr Other Payables* *Cr Other Operational Income*	 (2,675)	 2,675	 0

Impact of adjusted misstatements – 2021/22 (Continued)

Detail	Statement of Comprehensive Net Expenditure £000's	Statement of Financial Position £000's	Statement of Changes in Taxpayers' Equity £000's
Being adjustment for over accrual in relation to EY Commercial Modelling:			
Dr Accruals (less than 1 year)		8	0
Cr Other Operating Charges	(8)		
Being the correction for the holiday pay over-accrual:			
Dr Accruals (less than 1 year)		172	0
Cr Staff Costs	(172)		
Being correction of the net interest for pension costs:			
Dr Staff Costs	304		
Cr Retained Earnings		(304)	(304)
Being adjustment for the under accrual of the 21-22 audit fee:			
Dr Other Operating Charges	68		0
Cr Accruals (less than 1 year)		(68)	
Being correction of closing balances for investment property			
Dr Retained Earnings		7,040	7,040
Cr Revaluation Reserve	0	(562)	(562)
Cr Investment Properties		(6,478)	
Being correction of opening balances and in-year movements for investment property			
Dr Investment Properties		3,911	
Dr Retained Earnings	0	4,660	4,660
Cr Revaluation Reserve		(8,571)	(8,571)
Being correction of treatment of revaluation gains on investment properties			
Dr Retained Earnings		2,185	0
Cr Gain on Revaluation of Investment Property	(2,185)		

Impact of adjusted misstatements – 2021/22 (Continued)

Detail	Statement of Comprehensive Net Expenditure £000's	Statement of Financial Position £000's	Statement of Changes in Taxpayers' Equity £000's
Being reclassification of NGIWMS Income from short-term to long-term:			
Dr Deferred Income (less than 1 year)	0	729	0
Cr Deferred Income (greater than 1 year)		(729)	
Being management's correction of NGIWMS deferred income:			
Dr Deferred Income (less than 1 year)		1,956	
Dr Retained Earnings	0		115
Cr Deferred Income (greater than 1 year)		(2,071)	
Being management's adjustments following the completion of EY's valuation			
Dr PPE		288,238	288,238
Dr Depreciation charge	10,241		10,241
Dr Impairment	282		282
Cr Revaluation Reserve		(39,183)	(39,183)
Cr General Fund		(259,579)	(259,579)
Being management's correction of closing balances for PPE following review of working papers			
Dr PPE		1,410	
Dr Revaluation Reserve		8,214	8,214
Cr Depreciation charge	(6,367)		(6,367)
Cr Retained Earnings		(3,257)	(3,257)
Being reclassification of Heritage Assets			
Dr Heritage Assets	0	6,989	0
Cr PPE		(6,989)	
Being impairment not previously recognised			
Dr Impairment	251		251
Cr PPE (AUC)		(251)	

Impact of adjusted misstatements – 2021/22 (Continued)

Detail	**Statement of Comprehensive Net Expenditure £000's**	**Statement of Financial Position £000's**	**Statement of Changes in Taxpayers' Equity £000's**
Being adjustment made by management for duplications in additions - relating to two assets (NB see also unadjusted misstatements)			
Dr General Fund		2,996	2,996
Dr Revaluation Reserve		1,074	1,074
Cr PPE		(4,070)	
Being adjustment for AUC which became operational in the year and should have been depreciated			
Dr Depreciation Charge	49		49
Cr PPE		(49)	
Being removal of an asset not owned by Scottish Canals			
Dr Revaluation Reserve		117	117
Cr PPE		(107)	
Cr Depreciation charge	(10)		(10)
Being an adjustment made by management for unclassified WIP (NB see also unadjusted misstatements)			
Dr PPE	0	623	
Cr General Fund		(623)	(623)
Being adjustment to reflect share of profits from investments:			
Dr Investments		492	0
Cr Share of Profits from Investments	(492)		
Being adjustment for over accrual of retentions:			
Dr Accruals	0	85	0
Cr Property, Plant and Equipment		(85)	
Being adjustment for the WIP accrual:			
Dr Property, Plant and Equipment	0	47	0
Cr Accruals		(47)	
Being adjustment to reflect the short-term element of deferred income:			
Dr Deferred Income (greater than 1 year)	0	3,351	0
Cr Deferred Income (less than 1 year)		(3,351)	

UNADJUSTED MISSTATEMENTS

The table below provides details of the unadjusted misstatements identified during the 2021/22 audit. Note that under our audit methodology, where we have sampled using a statistical sample, we are required to extrapolate the error, over the total balance sampled to quantify the potential misstatement to the financial statements, in the context of materiality. These extrapolations, where relevant, are required to be reported below.

Detail	Statement of Comprehensive Net Expenditure £000's	Statement of Financial Position £000's	Statement of Changes in Taxpayers' Equity £000's
Unexplained difference between EY FAR output and accounts – in the absence of other evidence or an asset-by-asset breakdown which supports the balances in the accounts, this is presumed to be an error. Dr Reserves (presumed) Cr PPE	 0	 749 (749)	 749
Projected (estimated) risk of misstatement of PPE due to issues identified in testing of rights and obligations. This is a projection based on 1 actual error £100k and 1 item with insufficient evidence £97k. Dr Reserves (presumed) Cr PPE	 0	 1522 (1522)	 1522
Potential misstatement due to misclassification of operational assets as Assets Under Construction. 5 items tested became operational before year end based on the evidence viewed, while 2 did not have sufficient evidence to confirm either way. The total value of these items is £7.8m, and the projected (estimated) risk of misstatement in terms of the misclassification is £12.9m. However, as operational assets should be revalued but AUC is held at cost, we are unable to determine the potential misstatement.	Unable to determine	Unable to determine	Unable to determine
Spend on dredging capitalised as Assets Under Construction - in our view now the canals have been valued, management should consider this going forward in the context of the related canal asset. We would also need to be able to see evidence to support how, in doing this work, it takes it to a greater depth, to show the spend is adding value, and not just maintaining the asset. We have therefore been unable to obtain sufficient assurance that the total value of dredging £1,216k is appropriate to be capitalised. This is an area of uncertainty rather than a confirmed misstatement. Dr Expenditure Cr PPE (AUC)	1,216	 (1,216)	1,216

Detail	Statement of Comprehensive Net Expenditure £000's	Statement of Financial Position £000's	Statement of Changes in Taxpayers' Equity £000's
Potential misstatement of PPE due to issues identified in testing of additions. 7 items appear to relate to 2020/21 rather than 2021/22, 2 items are revenue costs rather than capital based on the evidence provided, 8 items do not have sufficient evidence to confirm whether they are revenue or capital in nature. The total value of these items is £1.8m, and the projected (estimated) risk of misstatement is £6.4m. However, some of these misstatements may be presentational in nature within the PPE note, while others may impact the SOCNE/SOFP, and we are unable to quantify the potential adjustments.	Unable to determine	Unable to determine	Unable to determine
Being reclassification of Heritage Assets (remaining amount unadjusted) Dr Heritage Assets Cr PPE	0	231 (231)	0
Potential misstatement of PPE due to being unable to obtain sufficient appropriate evidence to support the replacement costs used in the valuations of certain assets. The total value of these items within our sample was £169.3m, and the projected (estimated) risk of misstatement is £194.8m. This is an area of uncertainty rather than a confirmed misstatement. Dr Reserves (presumed) Cr PPE	0	194,807 (194,807)	194,807
Being correction of valuations for certain classes of lock Dr PPE (Structure) Cr Revaluation Reserve (presumed)	0	1,130 (1,130)	(1,130)

Detail	Statement of Comprehensive Net Expenditure £000's	Statement of Financial Position £000's	Statement of Changes in Taxpayers' Equity £000's
Potential misstatement of PPE due to being unable to obtain sufficient appropriate evidence to support the assumptions relating to residual values for assets where the valuation reflected a residual value equating to 12 years remaining utility (£129.8m, a subpopulation of the total of £354m). This estimate is highly sensitive – if a 10 year residual life was used instead then we estimate that the carrying value would reduce by £21.6m. This is an area of uncertainty rather than a confirmed misstatement. Note that this uncertainty covers some of the same assets as the uncertainty related to replacement costs highlighted above. Dr Reserves (presumed) Cr PPE	0	21,630 (21,630)	21,630
Being adjustment made by management for duplications in additions - relating to two assets (NB see also adjusted misstatements - management made this adjustment in the final version of the accounts but we have been unable to corroborate that the impact on closing balances is appropriate) Dr General Fund Dr Revaluation Reserve Cr PPE		1,074 2,996 (4,070)	1,074 2,996
Being an adjustment made by management for unclassified WIP (NB see also adjusted misstatements - management made this adjustment in the final version of the accounts but we have been unable to corroborate that the impact on closing balances is appropriate) Dr PPE Cr General Fund	0	(623) 623	623
Being adjustment for the under-accrual of the 21-22 audit fee: Dr Other Operating Charges Cr Accruals (less than 1 year)	8	(8)	8
Overall impact	**Unable to determine**	**Unable to determine**	**Unable to determine**

Misclassification and disclosure changes

The table below provides details of substantive misclassification and disclosure changes identified during the audit which have been made in the final set of financial statements. This is not a complete list, as this does not include minor changes requested by the audit team, including typos and formatting requests.

Disclosure	Auditor recommendations	Adjusted?
Critical Judgements and estimation uncertainty	International Financial Reporting standards prescribe the required disclosures in relation to critical judgements. It also requires separate consideration of accounting estimates. Significant estimates relate to assumptions and estimate at 31 March that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. Judgements relates to areas that aren't significant estimates. In the draft accounts, management have combined critical estimate and judgements. It is unclear from the disclosure what critical judgements have been applied. For significant estimates, it is unclear where management consider the key assumptions where there is an increase risk of a material change in the estimate over the next 12 months. There is an opportunity to enhance the disclosure to focus on those key areas of estimation that may have a significant risk of material misstatement in the next 12 months. This should focus on those key areas of assumptions such as pension fund discount rate or key assumptions in the valuation.	No – Audit have raised a recommendation, for the Accounting Policy as a whole as well as specifically, related to the critical and judgements and estimates within PPE.
Financial instruments	Accounting policy does not provide a clear explanation of the classification, measurement and accounting treatment under IFRS 9. Financial liabilities measured at amortised cost included the taxation and social security payable – since this arises from a statutory rather than contractual arrangement, it does not meet the definition of a financial instrument.	Partly – the accounting policy has not been updated however, the taxation and social security payable has been removed.

Disclosure	Auditor recommendations	Adjusted?
Contingent Liabilities/ Post Balance Sheet Events	Following inquiries with the Head of Legal within Scottish Canals, it was noted that the organisation had contingent liabilities which had not been disclosed within the financial statements. Additionally, as the audit process continued, changes were required to record and move items between contingent liabilities and post balance sheet events.	Yes
IFRS 15 Revenue from Contracts with Customers	The accounting policy in respect of revenue needs to be updated in line with IFRS 15 as not all disclosures applicable to IFRS 15 appear to be included in the accounts, however these are not considered material.	No
Investment Property	Notes to the account report that the investment property is measured at fair value and that all are considered to be level two in the fair value hierarchy. The disclosure requirements of IFRS 13 : 93 have not been met e.g. 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. The amounts recognised in the profit or loss for rental income and operating expenditure was also not disclosed.	Partially – not updated to provide further information around the fair value techniques
Remuneration and Staff Report	The appropriate section of the Remuneration and Staff Report that are audited were not clearly identified as being audited. Additionally, bandings within the Severance Payment disclosure had to be updated and the Fair Pay Disclosure did not include the updated disclosure requirements per the FReM and was based on the 2020/21 FReM requirements.	Yes
Related Parties	Additional disclosures were required around the relation between a Board member's partner being a Director at Sustrans and the transactions between Scottish Canals and MLT. Transaction amounts are not currently included for several related parties.	Partial

Disclosure	Auditor recommendations	Adjusted?
Operating Leases as Lessor	In the initial working schedule for the operating lessor note, the lease terms calculations and formula where incorrect, therefore, the lease disclosure note was incorrect. An updated spreadsheet was provided with updated figures and the accounts have subsequently been updated to reflect. Additionally, there was a lease included which did not commence until 22/23 and this was subsequently removed.	Yes
Capital Commitments	In the initial copy of the annual report and accounts received from management, there were no capital commitments disclosed. This was challenged with management and the disclosure was updated to reflect Scottish Canals' capital commitments.	Yes
Property, Plant and Equipment	We raised a number of queries due to not being able to agree the figures in the draft accounts to underlying working papers, or not being provided with asset-by-asset breakdowns supporting the figures in the accounts. Management have subsequently performed a more detailed review and made a number of adjustments to the PPE note (see also adjusted misstatements section of this report). This includes adjustments to the lines for cost/valuation at 1 April 2021, additions, transfers, revaluation, accumulated depreciation, depreciation charge and closing balances for gross cost/valuation, accumulated depreciation and net book value.	Yes
Property, Plant and Equipment	We identified a number of misstatements relating to PPE which would also impact the PPE disclosure note (see adjusted misstatements and unadjusted misstatements sections of this report). Additionally we identified errors in the 'transfers' line within the PPE note, and were unable to gain assurance over this disclosure. We also identified a £2.5m overstatement of gross cost for Real Estate relating to asset 3855 Pinkston Water Park Facility Building, which has nil NBV due to being intended to be excluded from the FAR (we understand this is due to being leased out).	Partial
Heritage assets	We identified that under the FReM, non-operational heritage assets should be shown separately on the face of the Statement of Financial Position (see adjusted misstatements). As a material balance, this will also require a separate disclosure note and policy.	Yes

Disclosure	Auditor recommendations	Adjusted?
Statement of Cash Flows	In the first version of the annual reports and accounts provided to audit, this disclosure was missing. This was subsequently provided in the latest version of the accounts. There were numerous errors in the initial version which required amendment.	Yes
Statement of Changes in Taxpayers' Equity	In the first version of the annual reports and accounts provided to audit, this disclosure was missing. This was subsequently provided in the latest version of the accounts.	Yes
Taxation	In the first version of the annual reports and accounts provided to audit, this disclosure was missing. This was subsequently provided in the latest version of the accounts.	Yes
Disclosure Adjustments	From our disclosure checklist completed and A1a of the Annual Report and Accounts, minor disclosure changes were made throughout. These included updated narrative disclosures around the segmental reporting note, the legislative authority for accounts production and inclusion of a cash and cash equivalents note. Additionally, it was noted that the format of the Annual Report and Accounts did not meet the required format per the FReM with more than the two sections (Performance Report and Accountability Report) as set out in the FReM being included and additional Accountable Officer sign offs were required at the end of each Report.	Yes
Finance Expenses	The finance expenses in the initial draft financial statements were incorrect and did not match the figures per the TB.	Yes
Prior Year Comparatives	There have been changes to prior year comparatives including the statement of cash flows, remuneration report, income (where reclassification has been made been two categories) and deferred income (where reclassification has been made between short and long term). We do not deem these to be material.	Yes

2. Recommendations from 2021/22 audit – Financial statements

We have set out below, based on our audit work undertaken in 2021/22 our external audit recommendations:

Recommendation	Agreed management response
1. Fixed Asset Register (FAR) – Creating the FAR and then maintenance At the time of concluding our audit, the underlying results from the valuation, and the review of assets, was still to be input into the Scottish Canals asset register. Various reconciliations and working papers were in existence, in manual form. The Fixed asset register should now be updated, and this will include a system generated depreciation calculation (as opposed to the manual calculation undertaken to report in the 2021/22 financial statements). Management should ensure that the updated FAR is complete and accurate, as it will form the basis of the underlying accounting records, over PPE going forward. Once updated management should determine suitable controls to maintain the accuracy and completeness of the FAR going forward. This will need to include controls over: recognition of assets, additions and enhancements, disposals and de-recognition of assets, and reconciliation of the AMX system and capital project information to the FAR throughout the year.	Management response: Agreed. Action owner: Director of Finance & Business Services Timescale for implementation: October 2023
2. Cut off and accounting records between AMX, project records and the FAR Suitable controls need to be established to support the accounting for PPE, within the financial statements. This includes an understanding, within the project team, on what is required, and when, specific to the accounts. This includes cut-off and a control to ensure when an asset is operational, finance are informed, as well as sharing of information to enable finance to identify if there are any impairments of Assets Under Construction that should be recognised. This will allow Canals to have sufficient records to support in-year additions and the Assets Under Construction balances in the accounts, in particular. The FAR will be the source, to inform the valuation of assets for accounting purposes.	Management response: Agreed. Action owner: Director of Finance & Business Services Timescale for implementation: October 2023

Recommendation	Agreed management response
3. Capital projects – Asset creation and ownership (right to use) of the assets Scottish Canals work with third party partners to maintain or enhance the Canal network, or land/infrastructure associated with the Canals. There needs to be clarity, within these projects, as to what assets Scottish Canals will subsequently own, or at what point, an asset may transfer into Scottish Canals' ownership. This includes how Scottish Canals will evidence that ownership. Certain projects and/or work, is maintaining an asset, which is not a Scottish Canals asset, and this needs to be clearer, so these assets are not incorrectly included on the Scottish Canals Balance Sheet.	Management response: Agreed. The Director of Finance and Business Services will develop a policy to ensure the Project Assurance Committee incorporates an ownership review as part of its remit and paperwork improvement. This will be part of the full project improvement with the Head of Legal, Head of Estates and Head of Engineering leading the project management and data capture. Action owner: Director of Finance & Business Services Timescale for implementation: October 2023
4. Future valuation For the 2021/22 Valuation, Scottish Canals commissioned a consulting firm. As we understand it, the valuation model developed is owned by the consultants and remains with them and Scottish Canals do not retain that model We understand, given the model is owned by the consultant and the work undertaken, Scottish Canals have commissioned the same consultant to support the 2022/23 valuation. Scottish Canals will need to ensure that they can evidence value for money, in the appointment of consulting support and over the longer term, consider what records they need to hold, to support a wider consideration of valuers, who could support Scottish Canals, to evidence value for money has been achieved, in the future.	Management response: Agreed. A risk-based decision to extend the current contract has been agreed in order to support the 2022/23 valuation, together with an analysis of the prior year property, plant and equipment note. At present the limit has been set at an additional £100k in total. This provides sufficient cover to also support audit queries from Audit Scotland, together with a full handover to new permanent staff, including a new Head of Finance and Statutory Reporting Manager to enable Scottish Canals to pursue a competitive tender for the 31/03/2024 financial year. Action owner: Director of Finance & Business Services Timescale for implementation: October 2023

Recommendation	Agreed management response
5. Assets not revalued The accounts include £10.9m of assets which were not subject to revaluation. From review, these include low value, low life assets where carrying value is unlikely to be materially different to current value. However, asset 5029 Bowling viaduct access (Bowline) is held at depreciated historic cost with NBV £4.7m (historic cost £4.9m), rather than being valued at depreciated replacement cost. There does not appear to be a material risk however we recommend that management consider including this asset in the valuation in future years.	Management response: Agreed. Action owner: Director of Finance & Business Services Timescale for implementation: October 2023
6. IFRS 16 considerations In 2022/23 Scottish Canals will need to account under IFRS 16 for the first time. This in effect will bring operating leases, into the Balance sheet for the first time. As a result, this may bring in additional assets, that under the FReM will require a valuation. Based on our knowledge of Scottish Canals, they do have a number of lease arrangements which will need careful consideration. In particular, we recommend that Scottish Canals also considers its relationship with Millenium Link Trust (MLT), and whether assets currently owned by MLT require recognition, within the Scottish Canals financial statements.	Management response: Agreed. Action owner: Director of Finance & Business Services Timescale for implementation: October 2023
7. Audit evidence to support the annual accounts process Management should ensure that sufficient supporting audit evidence is available to support the balances disclosed in the accounts. This includes ensuring audit records are available, that working papers to support balances in the accounts, do tie-back to the trial balance, which in turn ties to the unaudited accounts and that changes in versions of accounts and the trial balance are suitably tracked, to support the accounts process.	Management response: Agreed. Action owner: Director of Finance & Business Services Timescale for implementation: October 2023

Recommendation	Agreed management response
8. Critical judgements and estimates – PPE Specialised/networked assets In addition to reviewing the critical estimates and disclosures accounting policy (see recommendation 9), greater disclosure is required, to set out management's various judgements and estimates, in respect of the networked, specialised asset balance of £Million in the accounts. This would include useful economic life and residual values (canals themselves) and the material impact on the accounts, should different assumptions by adopted. This will be required to inform the user of the accounts, of the highly material nature, of the judgements adopted and on what basis Scottish Canals adopted these judgements, and what alternative judgements and estimates could be made.	Management response: Agreed. Action owner: Director of Finance & Business Services Timescale for implementation: August 2023
9. Accounting Policies – Critical Judgements and estimates The critical estimates and judgements accounting policy needs to be 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, pinpoint 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: Agreed. Action owner: Director of Finance & Business Services Timescale for implementation: August 2023

Recommendation	Agreed management response
10. Quality of the Unaudited Annual Report and Accounts The unaudited annual report and accounts were presented to the audit team on the 4th of January 2023. Prior to this, the audit team used the Trial Balance (as at July 2022) to select samples, and subsequent updated trial balances. It has been time consuming and difficult to reconcile the trial balance, shared for audit, to the unaudited accounts dated 4 January, and subsequent updated accounts. In addition, the version we did receive, was not complete and contained many errors. Particularly aspects missing included the tax computation, leases note, cash flow, statement of tax payers equity. A suitable future audit timeline should be agreed with the incoming auditors to allow management to produce a set of accounts for audit which are of a good quality and had sufficient time to be quality assured and checked by management.	Management response: Agreed. In July 2022, Scottish Canals provided the narrative of the financial statements, with a detailed trial balance. The extensive work of the canal valuation was agreed to begin in July and was not completed until October 2022. Therefore, the full financial statements containing the canal infrastructure valuation for the first time was not provided until the agreed later date of January 2023. This was a highly unusual year. There will be progression on the revised Fixed Asset Register to continue during the summer, and a delayed start to the 2022/23 audit until at least October 2023, and so it is expected that a full set of accounts will be available prior to audit next year. Action owner: Director of Finance & Business Services Timescale for implementation: October 2023
11. Journal Authorisation There is no automated reviewing/authorisation of journals posted in the ledger, with the system not being set up to facilitate this. Consequently, reliance is placed on month-end management accounting reviews and on balance sheet reconciliations, which Scottish Canals undertake to help identify any unusual journals being posted. From our journal testing completed, sufficient audit evidence was not always readily available to support the journal and we did note journals being incorrectly posted, requiring corrections.	Management response: Agreed. No system changes will be made at this time. However, with a new Financial Accountant and Finance Manager on board, additional month-end reconciliation and controls will begin to be rolled out over the course of the financial year 2023/24, beginning in March 2023. Journals will also be reviewed to ensure adequate back-up evidence is retained. Action owner: Director of Finance and Business Services Timescale for implementation: June 2023

Recommendation	Agreed management response
12. Related Parties Disclosure As part of our audit work, we completed a review over the completeness of the register of interest forms completed by members. From this review, we identified certain related parties which had not been disclosed within the signed forms, which are completed and updated on an annual basis. Management should confirm members fully understand the requirement to complete the forms and ensure the signed forms are reviewed and checked for accuracy and completeness, to ensure all appropriate related parties have been disclosed. Additionally, we recommend that management review the current related parties disclosure in line with Audit Scotland's related parties good practice note and consider whether additional disclosures including transaction amounts should be included for completeness.	Management response: Agreed. Action owner: Director of Finance & Business Services Timescale for implementation: August 2023
13. Investment Property Management Expert's Process As part of the valuation process, the 'Valuer' must prepare a written 'Terms of Engagement' document to set out the terms of how the instructions will be met. This is a mandatory requirement of the RICS Valuation – Global Standards 2022. The portfolio valuation 'Terms of Engagement' document obtained related to the previous financial period. As this is in line with 'best practice' expectations for this work, Scottish Canals should ensure these are obtained from the valuers on an annual basis. Additionally, Scottish Canals should ensure that formal 'Letter of Instructions' are agreed upon and signed by the relevant individual on an annual basis as these outline the base requirements and form a vital and mandatory part of the valuation process.	Management response: Agreed. Action owner: Head of Estates Timescale for implementation: August 2023
14. Disaster Recovery Plan It was noted that Scottish Canals do not have a formal Disaster Recovery Plan in place and although there appears to be arrangements in place for a disaster response, this is not clearly documented if action needs to be taken. A formalised plan should be developed and adopted to ensure the response to any significant disasters/failures are co-ordinated in an effective manner.	Management response: Agreed. Action owner: Director of Finance & Business Services Timescale for implementation: December 2023

3. Recommendations – Wider scope

We have set out below, based on our wider scope audit work undertaken in 2021/22 our external audit recommendations:

Recommendation	Agreed management response
1. Scottish Canals partnerships As recorded in the financial statements Scottish Canals work with a number of partners, on a joint basis, principally BIGG regeneration, and MLT. These partnerships have been in place for several years. As Scottish Canals refreshes its future strategy and direction it is recommended that they consider how value for money is evidenced in these partnerships, and that continued partnership supports the ambitions of Scottish Canals. Lastly, Scottish Canals currently do not produce group accounts with the rationale set out for this decision within the accounting policies note in the annual accounts. However, we recommend this is re-reviewed to ensure they are fully in compliance with the FREM and the relevant auditing and accounting standards, for considering and accounting for group relationships.	Management response: Agreed. Action owner: Director of Finance & Business Services Timescale for implementation: August 2023
2. Dundas hill The Dundas Hill strategy was first considered in 2017 and the strategy approved in 2019. Scottish Canals still own certain Dundas Hill plots, which are currently valued as an investment property. It is recommended that the Board review this strategy, in light of the new corporate plan being developed and market conditions, to determine the best use of the land Scottish Canals retain, and ensure that the correct basis for valuation is applied, based on the use/planned use, including if it is to be recorded as an asset held for sale.	Management response: Agreed. Action owner: Chief Executive Officer Timescale for implementation: August 2023

Recommendation	Agreed management response
3. Workforce planning The focus of the organisation has been settling the pay review. This concluded, via the Trade Unions and with Scottish Government in March. This now gives Scottish Canals employees certainty over pay. Scottish Canals should now develop a workforce plan, which considers the skills it requires as an organisation and within this plan, a recruitment and retention strategy as referenced more widely elsewhere in this report. This plan should also build in the need for/reliance on seasonable and contracted staff, within peak periods.	Management response: Agreed. Action owner: Director of People, Safety and Governance Timescale for implementation: December 2023
4. Financial sustainability – Medium to longer term financial plan Scottish Canals have started to consider a medium term financial plan, with EMT consideration of key assumptions. Once the new corporate plan is in place, a medium/longer term financial strategy should be prepared and approved by the Board. It is expected that this will take account, for example, of how Scottish Canals may need to reduce its cost base, the impact on Scottish Canals of inflation, rising construction costs, the new pay agreement, VAT arrangements.	Management response: Agreed. Action owner: Director of Finance & Business Services Timescale for implementation: August 2023

Recommendation	Agreed management response
5. Finance recruitment and capacity The Finance team is lacking in capacity, and wider skills and experience due to loss of key posts in year and an inability to recruit. We understand that a restructure of the finance team has been proposed, which is hoped will increase the interest from potential applicants. Scottish Canals should continue to do all it can, to fill the vacancies, as in particular the loss of Scottish Canals knowledge and experience, in finance, has had a significant, detrimental impact on the annual accounts process. Scottish Canals should also continue to explore across the wider NDPB network, what support other bodies could potentially provide.	**Management response:** Agreed. The difficulty in recruiting qualified finance personnel has been well documented and reported to the Board. As reflected in point 7 below, market rates for qualified personnel, the job evaluation process, the proposed move from Glasgow to Falkirk, and the pressure on the existing team with no knowledge of NDPB accounting until new appointments came in during the Spring of 2021. Resources to support the valuation project in particular were sought and secured from the NDPB sector, however, the appointed personnel then could not be made available. Although Scottish Canals has and continues to work closely with NDPBs, Transport Scotland and Scottish Government to seek opportunities for secondment, we have found no appropriate finance personnel have been available. In order to introduce some more resilience, Scottish Canals is currently recruiting both a Head of Finance and a Statutory Reporting Manager. Terms and conditions of staff members who have left were only four weeks, which provided difficulties in handovers. Notice periods for qualified members of staff have been doubled to eight weeks during the recent job evaluation programme. **Action owner:** Director of Finance & Business Services **Timescale for implementation:** December 2023

Recommendation	Agreed management response
6. VAT position We understand that the VAT position is likely to be concluded, by HMRC in late May/early June, following the internal review requested by Scottish Canals. In 2021/22, payments (without prejudice) of £4.150 million were made against the liability. Since the year-end, additional funding of £16.528 million has been provided and earmarked for the settlement of the liability. To date, Scottish Canals have taken a prudent approach to estimating VAT in the 2023/24 budget, capital and revenue. This will be revisited once a decision and outcome is reached by HMRC. This may result in Scottish Canals needing to make further savings, depending on the outcome. If the settlement is less than forecasted, Scottish Canals need to agree how the funding, not used, will be transferred back to Scottish Government.	Management response: Agreed. Action owner: Director of Finance & Business Services Timescale for implementation: July 2023 (pending any additional HMRC delay)

Recommendation	Agreed management response
7. Organisation attrition As reported in the narrative in the performance report, during 2021/22 Scottish Canals experienced a high level of attrition, particularly across Scottish Canals professional services functions. Reference is made, in the narrative to declining staff survey results, and comments received, in respect of leadership. Linked to wider workforce planning, analysis should be undertaken to understand, why across Scottish Canals the rate has increased, what positive action Scottish Canals can take, and how this will be monitored and reported, to support staff retention. This will reduce the inefficiency (and additional cost, in time and money) Scottish Canals have been experiencing across the organisation.	Management response: There were high levels of attrition across professional services during the period for the organisation. The "Great Resignation" reflects wider trends experienced by organisations arising out of the Covid 19 pandemic". This aligned with the uncertainty for the organisation which spanned 2021/22 and continued through some of 2022/23 included two major projects which provided additional uncertainty – job evaluation and the proposal to move the Glasgow Scottish Canals office to a new building at Lock 16. With the closure of the uncertainty of these remaining issues, it is not expected that the high level of attrition will continue into 2023/24. New terms and conditions include changes to notice periods for staff, which also provides additional resilience to succession planning. Workforce planning is a key priority in the coming year. Reporting of staff resourcing has been and continues to be monitored and addressed at the EMT on at least a monthly basis. Recent monthly reports has indicated that staff turnover has now significantly slowed. HR Business Partnering, engagement with recognised trade unions and an employee-led People Forum all support regular engagement with employees. Further investment in Learning and development, including customer service, leadership and management are important steps in recognising and developing the Scottish Canals team. Action owner: Director of People, Safety & Governance Timescale for implementation: December 2023

4. Follow up of 2020/21 recommendations

Recommendation

1. Accounting policies – Critical estimates and judgements and ability to supporting these estimates/judgements to auditors through the audit process

Original recommendation

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.

Initial 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.

2021/22 update: NOT IMPLEMENTED – as part of our audit findings misclassification and disclosure changes sections, we have raised a similar finding in relation to critical estimates and judgements as this has not been fully resolved in 2021/22.

Recommendation

2. Capital Accounting - FAR

Original recommendation

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.

Initial 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.

2021/22 update: CLOSED – This has been superseded with the 2021/22 valuation work reported in this report.

Recommendation

3. Accounting Treatment – Capital or Revenue Classification

Original recommendation

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.

Initial Management Response:

Scottish Canals does not believe that the source of funding, whether 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.

2021/22 update: CLOSED – Valuation work undertaken in 2021/22 and captured in this report. New recommendations included where relevant.

Recommendation

4. FReM Requirements – Valuation (non-Investment Properties)

Original recommendation

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.
- A control to routinely confirm existence of assets.

Initial Management Response:

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 202021/22 year-end.

Valuations will be re-conducted for those items which have been rejected by Grant Thornton, once the detail has been provided to Scottish Canals. 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.

2021/22 update: CLOSED – Superseded with the work undertaken by Scottish Canals in 2021/22.

Recommendation

5. Frequency of Board Meetings

Original recommendation

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 202021/22 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.

Initial Management Response:

The Executive and Board will consider this recommendation and review this in line with best practice.

2021/22 update: NOT IMPLEMENTED – ARRANGEMENTS IN 2023/24 – In 2021/22, the Scottish Canals board met 12 times and therefore, have not fully moved back to more normal governance arrangements following the pandemic.

6. Remuneration Committee

Original recommendation

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.

Initial Management Response:

The Executive and Board will consider this recommendation and review this in line with best practice.

2021/22 update: COMPLETED. Following Board approval at its meeting on 25 August 2022, based on good governance practice and the external auditors' recommendation, as supported by the ARC, the Remuneration Committee has been replaced by a private Board session to consider people matters. The Board noted that there was benefit to all Board Members scrutinising and challenging people matters specifically succession planning, job evaluation and pay in line with Scottish Government policy. The revised Matters Reserved to the Scottish Canals Board reflect this Board decision.

Recommendation

7. Deferred Capital Income – Conditions in contract to allow deferral of income in the account

Original recommendation

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.

Initial Management Response:

The Executive Team accepts this recommendation and will ensure new and future contracts meet the criteria as set out by FReM.

2021/22 update: CLOSED – Supporting evidence was provided to the audit team as part of deferred income testing supporting the deferral of income into future years.

8. Audit Process and Quality of the Unaudited Annual Report and Accounts

Original recommendation

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 202021/22 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.

Initial 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 202021/22.

2021/22 update: SUPERCEDED – This recommendation has been superseded by our 2021/22 recommendation.

Recommendation

9. Medium Term Financial Planning

Original recommendation

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.

Initial 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.

2021/22 update: ONGOING – The January Board received a paper outlining an initial medium term financial plan, covering the key areas of risk. This will be further considered when the new corporate plan is produced. The historic cost work, by EY, on Income has been completed and reported, and this will link to the future investment and corporate plans, as noted.

Recommendation

10. Future Sustainability of Scottish Canals as an Organisation

Original recommendation

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.

Initial 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.

2021/22 update: ONGOING – The EY work is still ongoing and will be used to inform the new Corporate plan.

5. Follow up of 2019/20 recommendations

Recommendation

1. IFRS 16 Leases

Original recommendation

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.

Initial Management Response:

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

2021/22 update: 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 2022/23. A further recommendation has been captured in the 2021/22 action plan.

6. Audit fees and independence

External Audit Fee

Service	Fees £
External Auditor Remuneration*	140,650
Pooled costs	7,310
Contribution to Audit Scotland costs	1,500
Contribution to Performance Audit and Best Value	0
2021/22 Fee	149,460

Fees for other services

Service	Fees £
Fee for the audit of the EU Grant Claim as agreed and completed in prior year	2,400

External Audit remuneration additional fees

* Additional audit fees have been incurred and these have been discussed and agreed with Management. This is predominantly due to the complexities of auditing the valuation. Additional fee (overrun) has been reflected in the External Auditor Remuneration line above, in addition to the baseline fee set by Audit Scotland of £31,610.

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 2021 (grantthornton.co.uk).

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 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.

Independence and ethics (continued)

As part of our assessment of our independence we note the following matters:

Matter	Conclusion
Relationships with Grant Thornton	We are not aware of any relationships between Grant Thornton and Scottish Canals that may reasonably be thought to bear on our integrity, independence and objectivity
Relationships and Investments held by individuals	We have not identified any potential issues in respect of personal relationships with the Group or investments in the Group held by individuals
Employment of Grant Thornton staff	We are not aware of any former Grant Thornton partners or staff being employed, or holding discussions n respect of employment, by Scottish Canals as a director or in a senior management role covering financial, accounting or control related areas.
Business relationships	We have not identified any business relationships between Grant Thornton and Scottish Canals.
Contingent fees in relation to non-audit services	No contingent fee arrangements are in place for non-audit services provided
Gifts and hospitality	We have not identified any gifts or hospitality provided to, or received from, a member of the Scottish Canals board, senior management or staff.

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 and consider that an objective reasonable and informed third party would take the same view. The firm and each covered person [and network firms] have complied with the Financial Reporting Council's Ethical Standard and confirm that we are independent and are able to express an objective opinion on the financial statements

7. 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	Audit Findings
Respective responsibilities of auditor and management/those charged with governance	•	
Overview of the planned scope and timing of the audit, including planning assessment of audit risks and wider scope risks	•	
Confirmation of independence and objectivity	•	•
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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