

# External Audit Report for Ferguson Marine (Port Glasgow) Holdings Limited (FMPG)

Financial year ended 31 March 2022

For the Accountable Officer, FMPG Board and the  
Auditor General for Scotland

February 2023



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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 Ferguson Marine (Port Glasgow) Holdings Limited (FMPG) 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 FMPG. The scope of our audit was set out in our External Audit Plan which was presented to the Audit Committee in March 2022:

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

- An audit of FMPG's 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.

This report is addressed to the Board and Accountable Officer of FMPG and the Auditor General for Scotland and will be published on Audit Scotland's website [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk) in due course.

## Responsibilities

FMPG 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 FMPG 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 particular during the 2021/22 external audit we have proactively sought to work with FMPG and Scottish Government on the future risks and uncertainty facing the organisation and how these are captured in the annual report and accounts. We sought to support the Board and Accountable officer, during the later part of the year identifying areas where the current FMPG arrangements could be improved, or amended to better suit the nature of FMPG as an organisation.

Recognising the requirements to comply with FReM alongside Company Act requirements (where relevant) we sought guidance from our audit technical team (commercial audit specialists). This has led to enhancements in the front-end commentary in the annual report and accounts.

# Audit of the annual report and accounts

## Key messages and judgements

We have identified 5 adjusted audit misstatements to the financial statements.

Disclosure corrections identified during our audit have been detailed in Appendix 1.

In year we considered the FReM and Companies Act requirements, to consider, what FMPG were required to comply with, where Companies Act differs or goes beyond the FReM. This resulted in further disclosures in the strategic (Performance) Report.

We have also raised recommendations for management as a result of our audit work in Appendix 2.

Our follow up of recommendations from the prior year's audit are detailed in Appendix 3.

## Our audit opinion

For the financial year ended 31 March 2022 we have issued a unmodified opinion on the annual report and accounts. Whilst not modified, we do highlight a material risk and uncertainty over the going concern of FMPG, as reported by Management in the annual report and accounts (pages 4 and 5 and Note 2, in the Accounting Policies). As reported in the independent auditor's report:

In our opinion the accompanying financial statements:

- give a true and fair view and were properly prepared in accordance with the financial reporting framework;
- expenditure and income were incurred in accordance with applicable enactments and guidance;
- the audited part of the Remuneration and Staff Report, Performance Report and Governance Statement are all consistent with the financial statements and properly prepared in accordance with the relevant legislation and directions made by Scottish Ministers.

## The audit process

In accordance with our annual external audit plan, our audit work commenced in late September 2022 and we received the unaudited financial statements (excluding the annual report) in line with our agreed timetable. The draft financial statements, in terms of balances disclosed were of a reasonable quality but would have benefited from further checking before submitting for audit. Our 2021/22 external audit work was completed remotely, with the audit team and FMPG management team working together effectively via Teams. The Accounts Direction requires FMPG accounts to comply with FReM. If the FReM contradicts Companies Act or is silent on Companies Act requirements our understanding is Companies Act then takes precedent over the FReM.

Certain aspects of the accounts are unusual for a standard public entity, for example, deferred tax and in this instance Companies Act requirements have been adopted. As a result we consulted with our commercial audit financial reporting colleagues and agreed certain amendments with management, to ensure compliance with the Companies Act, this was namely in the front end disclosures. Overall the finance team experience is not with FReM but in operating a finance function, including annual accounts, on a companies act basis.

We thank management and the finance team for their support and assistance during the audit process in particular their responses to audit queries.

# 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 Committee and finalised and submitted to Audit Scotland.

We updated our audit materiality to reflect your 2021/22 draft financial statements. Materiality was set at £1.112 million, representing 2% of total expenditure in the 2021/22 unaudited accounts. Performance materiality was set at £0.834 million, which is 75% of materiality.

We report to management any differences identified over £55,600 (trivial set at 5% of overall materiality).

We applied a lower materiality threshold of £10,000 for Senior Officers' Remuneration for disclosures within the Remuneration and Staff Report to ensure that Senior Officers' Remuneration has been disclosed appropriately.

## Internal control environment

In accordance with ISA requirements we have developed an understanding of FMPG's 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 approach as documented in our plan. Areas of recommendation have however been identified over the course of the audit and have been outlined in Appendix 2 of this report.

In particular, as acknowledged by management, the legacy financial systems have limited functionality, and financial information is currently retained across six differing systems. Financial reporting in-year to the Board is considered basic, and not at a granular level. Spreadsheets are used, to reallocate costs from the Holding company to the subsidiaries, and support the production of the accounts. The adequacy of the finance systems and controls will be a consideration, in any future business plan FMPG prepares, as to be competitive, and operate in an environment beyond the delivery of 801 and 802 improvements will need to be made, which will come with additional cost.

## 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.

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

### Risks identified in our Audit Plan

### Commentary

#### Management override of controls

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 FMPG's 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 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. Furthermore, we did not identify any indication of fraud or inappropriate management bias in accounting estimates that could result in a material misstatement.

## Risks identified in our Audit Plan

### Risk of Fraud or material error in expenditure

Operating expenditure is understated or not treated in the correct period (risk of fraud in expenditure). As payroll expenditure is well forecast and agreeable to underlying payroll systems, there is less opportunity for the risk of misstatement in this expenditure stream. We therefore focus on material non-pay expenditure streams. Commercial contracts (803-805) were completed during 2021/22 and we consider the risk of material misstatement within these to be low. We therefore focus on expenditure in relation to 801-802. We consider the risk to be particularly prevalent around the year end and therefore focus our testing on cut-off of material non-pay expenditure streams ensuring the completeness of expenditure. Our testing includes a specific focus on year end cut-off arrangements, where it may be advantageous for management to show an enhanced/different financial position in the context of reporting in-year to Scottish Government and the need to achieve the financial targets set.

## Commentary

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

- Walkthroughs of the controls and procedures over non-pay expenditure streams;
- Substantive testing of non-pay expenditure throughout the year to confirm its occurrence, accuracy and completeness of recording;
- Focused substantive testing of non-pay expenditure recognised post year end to identify if there is any potential understatement to ensure completeness of expenditure;
- Review of creditors, where material, around the year end to consider if there is any indication of understatement of balances held at year end through consideration of accounting estimates; and
- Unrecorded liability testing to confirm the completeness of year end liabilities as well as the completeness of expenditure recognised during the year.

### Conclusion

Through our audit procedures performed we did not identify any exceptions in our year end cut-off testing of expenditure. We did not identify any exceptions in the completeness and accuracy of accruals or payables balances at year end.

Within our wider scope commentary we have commented on the timing and sign off, of funding in-year by Scottish Government which resulted in FMPG committing expenditure in excess of funding, in the 3<sup>rd</sup> quarter of the 2022/23 financial year. Scottish Government were made aware of this position by FMPG and there are monthly finance meetings with FMPG management and Scottish Government to report and review the financial position.

## Detecting irregularities, including fraud

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

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

- We obtained an understanding of the legal and regulatory frameworks that are applicable to FMPG 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). The statutory act references Companies Act requirements. We have assumed per the Accounts Direction, FReM takes precedence but we have considered where Companies Act disclosures are required.
- We enquired of management and the Audit Committee, concerning FMPG's 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 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 FMPG's 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 FMPG's financial performance for the year and potential management bias in determining accounting estimates, as at 31 March 2022. Our audit procedures are documented within our response to the significant risk of management override of controls.
- 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 (rebutted given FMPG's income currently all comes via Scottish Government as owner and customer, providing income to cover the costs of 801 and 802) and significant accounting estimates.
- In assessing the potential risks of material misstatement, we obtained an understanding of:
  - FMPG's 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.
  - FMPG's control environment, including the policies and procedures implemented by FMPG to ensure compliance with the requirements of the financial reporting framework.



## Significant estimates and judgements

FMPG's 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 | In accordance with the FReM, FMPG is required to value property, plant and equipment on the basis of current value in existing use. As permitted within the FReM guidelines, the company has adopted a policy of using depreciated historical cost basis as a proxy for current value in existing use for assets within the classification of plant and equipment, on the basis that they have short useful lives of 5 years. For land and buildings, Management appointed an independent valuer, Graham + Sibbald LLP, to undertake a 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 FMPG is reasonable in estimating the value of property, plant and equipment and that there is no indication of management bias in the approach adopted. However, there is an opportunity for Management to review the finance function's understanding of the accounting treatment for property, plant and equipment valuations to ensure that all members of the finance team are familiar with the required accounting entries, the valuation arrangements and how these should be reflected in the financial statements. | ●<br>[Light purple] |

### Assessment

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

## Significant estimates and judgements (continued)

As set out in our Audit Plan, to ensure compliance with ISA 540 revised we requested further information from management in relation to the following estimates:

- Accruals
- Recoverability of receivables and construction contract assets
- Revenue at stage of completion
- Contract loss provision (nil balance as at 31<sup>st</sup> March 2022, having been fully utilised in 2021/22).

### IFRS 15 Revenue from Customers

We have considered FMPG's accounting of funding from Scottish Government for the delivery of 801 and 802 and how this funding is accounted for in the annual report and accounts. In considering the funding we have reviewed the contracts with Scottish Government for the completion of vessels 801 and 802. Based on discussions and review of the contract, the contract is a time and materials contract, through to completion.

Funding received from Scottish Government, where attributable to 801 and 802 is classified as income in the financial statements.

The accounts disclose an £8million capital contribution in-year, paid by Scottish Government to FMPG. During the audit process we challenged whether this was in fact revenue under contracts and therefore correctly disclosed. From review of the breakdown of the contribution, we noted this balance included Covid support and payment for losses incurred on the contracts out with 801 and 802. On this basis we determined the capital contribution treatment was correct. However, we requested management to make additional disclosure in the financial statements to ensure the make-up of this balance was clearly disclosed.

## 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   |
|--|--|
| <b>Matters in relation to fraud and irregularity</b> | It is FMPG's 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 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.   |
| <b>Accounting practices</b>                          | We have evaluated the appropriateness of FMPG's accounting policies, accounting estimates and financial statement disclosures. We confirm these are aligned to prior year and in accordance with the FReM and where applicable Companies Act requirements.   |
| <b>Matters in relation to related parties</b>        | We are not aware of any related parties or related party transactions which have not been disclosed. We note during the course of our audit that FMPG do not maintain a formal register of interested. See Action Plan.  |
| <b>Matters in relation to laws and regulations</b>   | 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.   |
| <b>Other information</b>                             | <p>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. No inconsistencies have been identified and we have issued an unmodified opinion in this respect.</p> <p>We did note that the Annual Report in sections is very repetitive and could be further streamlined to avoid duplication and improve the clarity of message to the reader of the annual report and accounts. In addition, going forward management should ensure any Companies Act reporting requirements, not captured in FReM, but relevant to FMPG are included in the unaudited accounts [see Action plan]</p> |

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## Other key elements of the financial statements (continued)

| Issue  | Commentary  |
|--|---|
| <b>Remuneration and Staff report</b>           | <p>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.</p> <p>We note that during the year a performance related bonus was paid. The disclosure of this, has been enhanced in the final version of the annual report and accounts to comply with the FReM requirements.</p>   |
| <b>Governance report</b>                       | <p>The Governance Report is set out on pages 7 to 10 of the Annual Report and Accounts. The report sets out how FMPG has been governed during 2021/22, including FMPG Board and Audit Committee members and how they support the achievement of FMPG 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 FMPG 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 FMPG for securing and evidencing Best Value.</p> <p>The governance statement, as disclosed, meets the requirements of the FReM. However, due to the nature of FMPG as an entity, they are not fully in compliance with the Framework Document (agreement between Scottish Government and FMPG), as set out, and it is difficult for the entity to meet the full requirements of the SPFM. This is reported in our wider scope reporting.</p> |
| <b>Matters on which we report by exception</b> | <p>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.</p> <p>We have nothing to report in respect of these matters.</p>   |

| Issue                   | Commentary   |
|-------------------------|--|
| Written representations | <p>We received a signed letter of representation from the Accountable Officer alongside the final annual report and accounts. This confirmed there were no subsequent events at the date of signing which would impact on the 2021/22 financial statements.</p>  |
| Going concern           | <p>We have considered FMPG’s ability to continue as a going concern, for a 12 month period beyond the date of signing the 2021/22 audit report (January 2023). Recognising the nature of FMPG as an organisation we have determined in this case we cannot assess FMPG’s going concern in accordance with the FRC Statement of Recommended Practice – Practice Note 10: Audit of financial statements of public sector bodies in the United Kingdom (Revised 2020). We have concluded under PN10 the continuing service provision does not apply. Whilst FMPG is currently classed as a public sector entity, the Government does not have a statutory responsibility to provide these services, so the continuing service assessment is not appropriate.</p> <p>The accounts set out in the performance report management’s assessment of going concern where management highlight the risks and uncertainties in the organisations ability to continue as a going concern (pages 4 and 5). As a result of this our audit opinion includes reference to a risk of a material uncertainty over FMPG’s ability to continue as a going concern, for at least 12 months from date of signing our opinion. See additional narrative on page 16 of this report.</p> |
| Regularity              | <p>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.</p> <p>In our opinion, in all material respects, the expenditure and income in the financial statements were incurred or applied in accordance with any applicable enactments and guidance issued by the Scottish Ministers.</p>   |

**Wider scope audit**

# Wider Scope commentary

In accordance with the Audit Scotland Code of Audit Practice (2016) we are required to consider wider scope audit work, in particular conclude on the wider scope audit risks identified and the audited bodies arrangements. Wider scope covers financial management, financial sustainability, Governance and Value for Money. Within our audit plan we identified the following wider scope risks:

- Financial sustainability. This included FMPG's wider business plans beyond the delivery of the 801 and 802 contracts;
- Governance and transparency arrangements, including the arrangements FMPG are establishing to comply with the Scottish Public Finance Manual (SPFM) and the framework document as agreed between FMPG and Scottish Government.
- Considering the findings from Audit Scotland's independent report, in particular applicability to FMPG's ongoing role in the delivery of vessels 801 and 802 (rather than legacy matters identified, from the previous organisation and original contracting)

In addition during the year additional areas of risk and focus have emerged. We have captured our broader considerations in this section of our report.

## Going Concern considerations

As auditors, for public sector organisations, we would assess going concern under the Financial Reporting Council (FRC's) Practice Note 10. This practice note recognises the statutory nature of services provided within the public sector, and that whilst a body may not continue to provide a service, the service itself is a statutory service, which would still be provided to the public sector.

It is not appropriate for us to evaluate FMPG under PN10. The Scottish Government do not have a statutory obligation, over shipbuilding, and FMPG as an entity, whilst wholly owned by Scottish Government also has commercial subsidiaries, companies limited by Guarantee. In light of the continuing service provision in PN10, we did not believe that FMPG met this criteria. We have therefore evaluated FMPG's ability to continue as a going concern, for at least 12 months from the date of signing the opinion on the 2021/22 financial statements (January 2023), under ISA 570. Our consideration of going concern has been informed by:

- Managements assessment of going concern and discussion with management
- Review of cash flow forecasts for the next 12 months including estimates made by management
- The letter of comfort issued by Scottish Government to the FMPG Board in late December 2022, alongside announcements in the December 2022 budget settlement.

Within the FMPG annual report and accounts management have identified risks and uncertainties to the organisation continuing. These are reflected in the Going concern note, to the accounts and the performance report (pages 4 and 5 of the annual report and accounts). Risks outlined by management include the outcome of the Government's due diligence over FMPG's cost to complete forecast and the current gap in funding between what is forecast as total cost to budget allocation, recognising an environment of ongoing costs to date; due diligence over the future of FMPG as an entity, including investment required, that the Commercial subsidiary has limited commercial contracted work at this point in time, and wider investment will be needed in the Yard to compete, depending on the future of FMPG.

Based on our consideration we noted:

- The cash flows include estimates and uncertainty, including income from future contracts being won, and Government funding ending on completion of 801 and 802 (the first quarter of 2024 based on planned timeline at time of audit)
- The current income from BAE, which is a secondment of 18 employees from FMPG to BAE to work in their Govan shipyard. This is the only commercial work FMPG have, at the point of our audit work and report.
- Reliance on income, which is only funded from Scottish Government to cover the costs to deliver 801 and 802.
- A potential pipeline, in the small ferry replacement programme, which has not yet been issued out to tender by CMAL. This would be subject to FMPG tendering and being the successful bidder. To date, any commercial contract work bid for FMPG have been unsuccessful.
- The Scottish Government letter of comfort contains several caveats in the assurance provided on ensuring value for money.
- The unknown outcome of the Scottish Government consulting review commissioned and how this may impact on the future of FMPG, and its ability to exist and continue in its current form.



## Risks and uncertainties

Management in the annual report and accounts have outlined a series of risks and uncertainties facing FMPG. Based on the narrative and our discussions with FMPG, the following are those we consider key, to the future of FMPG:

### *Delivery of 801 and 802*

- We understand Scottish Government are still committed to the contract that would see 801 and 802 completed.
- Whether the full estimated costs of completion will be met, as estimated at December 2022. The December budget announced additional funding through to March 2023, and in 2023/24. On review the current funding allocated is circa £12 million less than forecast costs to complete. This is based on the review of FMPG's financial forecasts by consultants commission by Scottish Government.

### *Funding provided by Scottish Government*

- The only substantial income that FMPG currently are in receipt of, is funding Scottish Government provide to FMPG to fund 801 and 802. There is no agreed funding for future investment in FMPG beyond 801 and 802 at this stage.

### *Future Investment in FMPG*

- FMPG are considering future business plans. For the organisation to be competitive and win new commercial contracts a degree of future investment is required in the yard itself. As a wholly owned public sector organisation the only source of funding available to FMPG is from Government. The level of investment has not been confirmed by Government.

### *Future work once 801 and 802 delivered*

- A framework contract is in place which is based on FMPG seconding staff to a private company (BAE), to support with their shipbuilding programme. This programme supports the other organisation in providing suitably qualified and experienced staff. It benefits FMPG, in upskilling and additional training for those seconded over, and allows for full utilisation of staff, who are at this stage not required to be working on 801 and 802. This is currently relatively small from a cash flow perspective. It could be upscaled, but this is dependent on the future of FMPG, the delivery of 801 and 802, and the FMPG's strategic direction of travel. For further work under this contract (or others) Scottish Government will need to evidence their full commitment to FMPG as an organisation.

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### *Future work once 801 and 802 delivered (continued)*

- Within the business plan FMPG are considering future commercial tenders and contracts, and have a pipeline of tenders they could compete in. This will be dependent on the tenders coming out, the future specifications and how FMPG can invest, where required.

In both options outlined, the investment in the yard would differ and the future workforce requirements, and skills needed differ. In each case time would be needed for FMPG to make the workforce changes required.

### *Other factors for consideration:*

Increasingly FMPG have other factors impacting on them, which at this stage are difficult to quantify. Factors include:

- Rising inflation costs and the impact on supplies. This is likely to have the most significant impact on the delivery of 802.
- Workforce skills and capacity. This is in part being managed from using skills via overseas contractors, but will also depend on the future operating model. Overall, there is currently limited shipbuilding skills available within Scotland, and FMPG have to date been unable to compete with private sector suppliers on salaries. The permanent workforce within FMPG, whilst skilled, is an aging workforce.
- The Director of Finance resigned in November 2022. An interim Director of Finance has been appointed, who started in January. The cost of this post is £140,000 per annum. The Director of Finance's salary, when leaving FMPG in February was £127,300.
- Closing down/out the inefficiencies currently being experienced in delivering 801 in particular (design and delivery)
- Ensuring the yard remains fully compliant with Health and Safety requirements.
- Intended routes. In November 2022 the Scottish Government announced that the planned route for 801 would be delivered by a different vessel. There is, as a result, not full clarity at this time, on the intended new route for 801 and how, if at all, the route change impacts on the need for the vessels as currently being built.

## Performance related pay

The employment contracts for the Senior Management team, employed in 2019 when FMPG came into public ownership contained a clause, entitling the employee to a performance related bonus of up to 20% of their base salary per annum. In 2021/22 a performance bonus was paid to six employees, of £87,000 in total. This payment was approved by the Remuneration Committee, based on a decision by the then Chief Executive. The letter issued to the employees confirmed the performance bonus was due to the structural completion of the hull on 801. In respect of this decision, we note:

- The remuneration committee minute is brief, noting the decision.
- Based on a short paper by the Chief Executive, it was recommended that 7.5% should be paid, on delivery of a milestone determined by FMPG. The remaining 10% paid was discretionary based on performance. We were unable to evidence the evaluation over this discretionary element and how decision making was reached.
- There was no key performance indicators, or broad performance management framework, at the time, which sets out how performance was to be assessed and measured. Either for the 801/802 delivery milestones or any individual performance discretionary element.
- Scottish government were unaware of this bonus, and it was not subject to Scottish Government approval.

Overall, there was a lack of transparency and good governance over these payments.

There is inconsistency and a lack of defined requirements, within the Framework Document, concerning FMPG and pay. We note the Scottish Government pay policy itself doesn't refer to FMPG being covered. The pay policy, in 2021/22 suspended payment of performance related bonuses.

The framework agreement says "the Scottish Government Remuneration Group, have decided that FMPG should not be obligated to comply with public sector pay and conditions. This is with the condition that FMPG maintain regular dialogue with SG Finance Pay Policy on any pay proposals, with an expectation that these will be broadly consistent with the provisions of SG Pay Policy for Staff Pay Remits. Any significant deviations will require further approval." "Significant deviations" or "broadly consistent" are not defined in the agreement. We understand in this case, Scottish Government were not aware of the payment until review of the 2021/22 financial statements.

The Framework agreement also says it is for the "Portfolio Accountable Officer to ensure that ...FMPG is compliant with relevant guidance issued by Scottish Ministers, the SPFM and, when applicable, with SG Pay Policy."

Therefore, we have determined there is a lack of clarity within the Framework document itself and no communication (and approval or otherwise) from Scottish Government.

## Chief Executive arrangements

In 2021/22 FMPG appointed a permanent Chief Executive, who is the Accountable Officer. The recruitment process was supported by an external recruitment agency, and as part of the recruitment, salaries benchmarked, with similar industries. The appointment of the Chief Executive was made by the FMPG Board, with Scottish Government approval. The salary and overall employment package was signed off by the relevant parties within Scottish Government. The package, includes a base salary of £205,000 alongside a performance related bonus of up to 40% of base salary, based on KPI's. Like the point noted above on performance related pay, at the time of appointing the Chief Executive, there was not a KPI Framework established, to assess performance. No bonus was paid to the Chief Executive in 2021/22.

## Performance related pay going forward

In November 2022 FMPG Remuneration committee considered a performance framework, for both Senior Managers and the Chief Executive. This was based upon a project plan and milestone delivery, outlined by the Chief Executive.. There were 10 metrics agreed: 4 related to 801, 3 related to 802 and 3 which are personal to each individual. The paper proposed a series of payment dates, paying the total performance bonus in instalments. This was proposed for initial payment in April 2023 and June 2023. Whilst approved by the Remuneration Committee at the time of the audit, this had not yet been discussed or approved by Scottish Government.

Going forward there needs to be complete clarity over what public sector pay policies do apply to FMPG and what do not. Our understanding of the current framework is that FMPG require Scottish Government approval prior to making any performance related payments. In addition, clarity would be beneficial when FMPG set salaries, and what approval is required by Scottish Government, and how salaries are benchmarked for FMPG, to what, and when is the public sector nature of the entity considered.

## Forecast costs on 801 and 802 and timing of Scottish Government funding

During 2022 Scottish Government commissioned an independent consultant to review FMPG's financial forecasts including key assumptions underpinning 801 and 802. This work was concluded late in December 2022 and shared with the audit team late January, once it had been received by FMPG.

The total costs forecast on 801 and 802, through to completion as at October 2022, based on this report are £27 million on 801 and £70million on 802. A total funding requirement, as at October 2022 was calculated at £224 million (from FMPG coming into public ownership, to completion), reflecting unallocated costs, warranties and a % of contingency.

Funding allocated for 2022/23 and 2023/24 through to planned completion by Scottish Government is £118.7 million, as announced in the December 2022 budget, and spring revision. There is currently an unfunded gap of £12 million.

The financial due diligence report highlights that whilst the forecasting undertaken by FMPG is reasonable, and based on FMPG underlying records, there are still a number of assumptions and judgements within the forecast. In particular it is highlighted:

- The need for sufficient contingency, given the history to date, and a profile of increasing financial cost
- Design and delivery risk, which could lead to re-work and whether any of this could be clawed back from third party contractors (where responsibility rests with the contractor)
- Increasing inflation cost and general pressures (cost and demand) on the construction sector

In October to mid-December FMPG were in a position where they had made expenditure commitments (between £10m and £15million) beyond the 2022/23 budget allocation by Scottish Government to FMPG. Commitments were made, out with normal funding arrangements, to continue to work on completing the two vessels and in the context Scottish Government and Parliament were aware of the delays in timeline and additional costs being incurred. FMPG meet with Scottish Government representatives monthly to discuss the financial position. The lack of transparency, for FMPG, over whether committed costs would be funded, had to be escalated to Scottish Government and caused a period of unnecessary uncertainty.

Looking ahead, FMPG and Scottish Government should continue to work together over financial forecasts and delivery timelines, and look to agree how the current gap, between total forecast cost and funding allocated, is bridged. See Action plan.

## Timeline for the delivery of 801 and 802

Scottish Government, as purchaser (customer) of 801/802 agreed a new contract with FMPG during 2020/21. This contract covers the costs and subsequent delivery of 801 and 802 to the Scottish Government. Under the contract, 801 and 802, as assets, sit under the ownership of Scottish Government. As a result, 801 and 802, are not recorded in the FMPG financial statements. What is in the financial statements is the costs incurred in building 801 and 802 and the funding provided to FMPG by the Scottish Government to cover those costs.

The contract, as we understand it, commits the Scottish Government to funding all costs associated with 801 and 802 through to delivery. There is in the contract, a termination clause, which Scottish Government would need to enact, in order to legally terminate the contract. The clause, is one on the timeline of delivery, of 801 and 802. If any revisions to the timeline were considered no longer acceptable to Scottish Government, then they could terminate the contract. The timeline, anticipated at the time of the contract, was for 801 and 802 to be delivered by April 2022. The revised dates for delivery are now during 2023 and the first quarter of 2024. At the time of writing this external audit report, and signing of the accounts, these reviewed dates had not been formally agreed to be Scottish Government.

Through discussion with FMPG and Scottish Government we note that consultancy work commissioned by Scottish Government is ongoing. We understand this work covers two aspects. The first, was the due diligence assessment of FMPG's cost assessment, to complete 801 and 802 and whether this is reasonable, or otherwise. The second phase, is broader, including options for the future delivery of 801 and 802, alongside wider options on FMPG as an entity going forward. This is not yet concluded, with Scottish Government yet to give a timeline. It will, however, need concluding, to allow FMPG to produce a business plan, by the agreed March 2023 date.

## Framework document and Accounts Direction

Over the course of 2021/22 Scottish Government finalised the Framework Direction for FMPG. FMPG is classed as a Non-Departmental Public Body, which is fully owned by Scottish Government. The framework document largely mirrors the framework document we have seen in place and agreed between Scottish Government and other NDPBs. The framework document sets out the obligations and requirements for FMPG as a public sector organisation including how FMPG should comply with the SPFM.

Under the statutory powers that created FMPG as an NDPB it is noted that FMPG will be considered to meet the requirements of an NDPB whilst fully funded by Scottish Government. Once 801 and 802 are delivered, it is anticipated that FMPG will then work on new contracts, awarded through competitive procurement, under the FMPG Commercial Ltd subsidiary.

The framework document, as currently set out, also does not recognise that unlike other public sector bodies FMPG is a company, limited by Guarantee registered with Companies House. This includes the holding company (which is an NDPB) and the wholly owned subsidiaries (Companies limited by Guarantee). The Board of Directors are all registered with Companies House as Directors, and this brings differing legal requirements, compared with other routine NDPBs. The framework document is silent on what takes precedent.

The Accounts Direction, which is what FMPG comply with, requires the annual report and accounts to be prepared under the FREM.

In reviewing the FREM we noted that the FREM can be applied, unless it results in a departure from a requirement within the Companies Act and, in this situation, as a limited company we would expect those requirements to take precedent. This is mirrored in the statutory references, which reference Companies Act 2006 and directions under the Public Finance and Accountability (Scotland) Act 2000. Given the accounts are submitted to Companies House, as well as completing the FREM disclosure checklist, we also asked our commercial technical support team to review the accounts, through the lens of a company. Particularly as the accounts include tax and deferred tax which is not usual in a public sector entity, with limited guidance in FREM. This led to enhanced disclosures being made.

## Compliance with the SPFM and governance and transparency

In accordance with the Framework document produced by Scottish Government, FMPG is a wholly owned NDPB. The framework document references the need for the organisation to comply with the Scottish Public Finance Manual (SPFM) and this is mirrored in the Accountable Officers letter of appointment. Inherent in the SPFM is the need for public sector bodies to be open and transparent.

Throughout the financial year and to date, FMPG have regularly updated the Scottish Parliament on the progress in delivering 801 and 802. Where difficulties have been identified, these have been reported through to the Net Zero, Energy and Transport Committee of the Scottish Parliament. Principal updates took place in June 2022, end of September 2022 and end of October 2022. Reporting highlighted the cables, the fuel system, re-profiling of the timeline, and the various challenges FMPG were experiencing. The Chief Executive's letter to the Committee are available via the Scottish Parliament website as well as the FMPG website. Delivery, and progress is reported in a transparent manner, external to FMPG to the customer, and owner, Scottish Government.

### *FMPG Committee and Board minutes*

During the 2021/22 financial year, FMPG had absences in its administration team, with several changes in personnel experienced. This did impact on FMPG's ability to ensure that they maintained sufficient records of the Board and Committee meetings during the year. Based on our review of the Board, Audit Committee and Remuneration Committee minutes we would note:

- These can be brief. Board minutes are often not more than a page and do not always clearly evidence decisions taken, or discussion, where a verbal update is provided rather than a paper included in the Board pack.
- They do not capture broader discussions, debate and challenge (as appropriate for a record of a meeting)
- In certain cases, they mirror an agenda rather than a meeting minute
- The papers that support the agenda items at times are limited, with many updates provided verbally. It is good governance practice, to have supporting papers even if short, and in the instances of verbal updates the minutes become an even more important record.
- There is often a time delay in the production and then availability of the minute, as circulated for comment before finalisation and then publication of the website.

FMPG will need to find a balance, recognising their current responsibilities as a public sector organisation, to maintaining openness and transparency. This will need to be done, recognising, the commercial side of FMPG, needs to maintain confidentiality, and act, like a private sector company. In addition, FMPG will need to balance the time and cost, into meeting these requirements of the SPFM and the Framework Direction, and the importance of delivery, in a context that in the future they may not longer be a public sector entity. [See Action plan and wider comment on the Framework Direction]



## Value for Money

As Accountable Officer of an NDPB, the FMPG Chief Executive is required to ensure and demonstrate value for money. In addition, as outlined by the Scottish Government in their Letter of Comfort Scottish Government are required to also ensure value for money in their decision making and use of public funds.

Given the increasing costs of delivery, the cost to complete the vessels will be in excess of the resultant asset value, and therefore using this financial metric will not evidence or demonstrate value for money.

A Value for money assessment in the current context could be FMPG ensuring that the two vessels are complete in as efficient and effective manner as possible, reducing inefficiencies through re-work, either in design or in the build, to the timeline agreed. We recommend that In measuring the achievement of value for money, a clear definition is needed which works for FMPG and Scottish Government, recognising the past context, but focused on the future of the organisation. See Action plan.

## Timing of SPFM compliance as set out in the framework document

As outlined in our commentary certain aspects of the framework document and ultimately the SPFM are not currently compatible with FMPG's arrangements. There will be time and cost incurred for FMPG to pursue these areas for what may be for a short period of time, depending on FMPG business plan, and ultimate plans of Scottish Ministers.

These areas include:

- FMPG currently do not have an internal audit function
- Risk management is in its infancy although a strategic risk register has been developed and considered by the Audit Committee and the Board.

It is recommended FMPG review these requirements again with Scottish Government, and the necessity of them, now. If it is determined that FMPG need to evidence full compliance with SPFM then additional support will be needed from the Scottish Government, in terms of funding, but also the wider public sector knowledge and experience. See Action Plan.

# 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. We can report there were five corrected misstatements to the financial statements arising during our audit. There were no uncorrected misstatement to the financial statements. None of the identified misstatements are considered material to the financial statements

## Impact of adjusted misstatements

The table below provides details of the adjusted misstatements identified during the audit:

| Detail  | Statement of Comprehensive<br>Net Expenditure £ | Statement of Financial Position<br>£ |
|---|---|--------------------------------------|
| Cr Gain on revaluation of property<br><i>Being adjustment to the face of the CIES for erroneous balance disclosed</i>                                       | (267,000)                                       | -                                    |
| Dr Deferred tax asset   | 580,000   | -                                    |
| Dr Deferred tax on property revaluation   | -   | 580,000                              |
| Cr Deferred tax liability   | (580,000)                                       | -                                    |
| Cr Deferred tax on net deficit on ordinary activities<br><i>Being recognition of deferred tax arising from tax computation</i>                              | -   | (580,000)                            |
| Dr Construction contract asset  | -   | 214,000                              |
| Cr Revenue<br><i>Being correction for revenue not recorded in 801-802</i>   | (214,000)                                       |                                      |
| Dr Administrative expenses  | 19,000  | -                                    |
| Cr Creditors: amounts falling due within one year<br><i>Being correction for administrative expenses not initially recorded in the financial statements</i> | -   | (19,000)                             |

## Impact of adjusted misstatements (continued)

| Detail  | Statement of Comprehensive<br>Net Expenditure £ | Statement of Financial Position<br>£ |
|---|---|--------------------------------------|
| Dr Property, plant and equipment  | -   | 37,000                               |
| Cr Gain on revaluation of property  | (37,000)  | -                                    |
| <i>Being adjustment to gain on revaluation upon reversing valuation incorrectly applied to assets which were not revalued</i> |   |                                      |

## Misclassification and disclosure changes

The table below provides details of misclassification and disclosure changes identified during the audit which have been made in the final set of financial statements.

| Disclosure                        | Auditor recommendations   | Adjusted? |
|-----------------------------------|---|-----------|
| Remuneration Report               | <p>The Remuneration Report required updating to include incentive payments made to senior management in the year.</p> <p>The Fair Pay disclosure required updating to meet new requirements per the 2021/22 FReM.</p> <p>The Exit Packages disclosure was updated to reflect a second exit package not initially disclosed in the first draft.</p>  | Yes       |
| Property, plant and equipment     | <p>No gain increase in cost arising on revaluation was initially recorded in the note. This required updating to £315,000.</p> <p>The opening cost of plant and machinery was incorrectly recorded as £2,263,000. This required updating to £2,963,000.</p> <p>The presentation of assets under construction in the prior year comparative table was amended to ensure consistency with the prior year signed accounts.</p> | Yes       |
| Construction Contract Assets      | The prior year amount had been disclosed in place of the current year amount in the disclosure note. This required updating for 2021/22.  | Yes       |
| Taxation                          | The Taxation note required full amendment on receipt of an updated tax computation from the external tax advisor  | Yes       |
| Deferred tax liabilities/(assets) | New note required disclosure in the year to account for the deferred tax asset and liability arising from the updated tax computation from the external tax advisor   | Yes       |
| Capital Contribution              | Confirmation this was not a loan from Scottish Government and therefore not repayable, updated in the Accounting Policy note. Additional explanation on nature of the £8m added into the note for the users of the financial statements.  | Yes       |

| <b>Disclosure</b>   | <b>Auditor recommendations</b>  | <b>Adjusted?</b> |
|---|---|------------------|
| Related Parties   | The related parties noted required amendment to include the Scottish Government as a related party in line with Audit Scotland Good Practice Guidance.  | Yes              |
| Goodwill  | The prior year goodwill note required amendment for the inclusion of the opening cost and amortisation as at 01 April 2020.   | Yes              |
| Staff Costs   | The Staff Costs note was amended to remove 'Other' staff as disclosed in the remuneration report, to ensure only actual employees were disclosed within the note. This resulted in a prior year restatement for the 2020-21 figures, which was a material reduction of £3.178m in the total disclosed in 2020-21.   | Yes              |
| Summary of significant accounting policies: Going Concern | Review of the Going Concern disclosure by management on emergence of the risks and uncertainties arising during the audit period over the future of FMPG, in its current form.  | Yes              |
| Consolidated Statement of Changes in Taxpayers' Equity:   | The first draft of the financial statements did not include a prior year comparative table for the Consolidated Statement of Changes in Taxpayers' Equity   | Yes              |
| Financial assets and financial liabilities                | Financial assets amortised at cost required updating to include the full balance of other receivables and the RDEC claim.<br>Financial liabilities at amortised cost required updating to remove the annual leave accrual from accruals, given this is not a financial liability settled by cash.   | Yes              |
| IFRS 16   | FMPG have adopted IFRS 16 early (not in FReM until 22/23 financial year). On review, some of the language to disclose leases was not in accordance with the terminology in IFRS 16 and this has been amended.   | Yes              |
| Prior year restatement – Creditors and Debtors            | In prior year due to the timing of the contracts being novated and a new contract an equal and opposite asset and liability was recognised. On review, given related to the same contract we determined this should in fact be netted off. The net impact of this on the prior year accounts was nil as removed the £23million asset and corresponding liability. | Yes              |

| Disclosure                                     | Auditor recommendations   | Adjusted?   |
|--|---|---|
| Consolidated Statement of Cash Flows:          | <p>The following changes were required to line items within the statement:</p> <ul style="list-style-type: none"> <li>- Movement in working capital amended from £1.081m to (£6.601m).</li> <li>- Capital contribution from shareholder amended from nil to £8m.</li> <li>- Various other minor rounding amendments</li> </ul> <p>Each of these affected the totals disclosed within the 'Net cash generated' section of the statement.</p> | Yes   |
| Analysis of Revenue:                           | <p>The note required updating for figures disclosed under 'Revenue expected to be recognised' where initial estimates had been used. The figure was revised to account for the value of the current contracts for 801-802, less costs incurred to date.</p>   | Yes   |
| Creditors: amounts falling due within one year | <p>£749,000 initially disclosed as a construction contract liability were reclassified to accruals and deferred income within the note.</p>   | Yes   |
| Right-of-use assets and liability              | <p>The opening gross carrying amount required updating from £507,000 to £675,000 to agree to the prior year closing amount.</p> <p>Additions required amendment from £4,000 to nil.</p> <p>Opening depreciation required amendment from nil to £168,000 to agree to the prior year closing amount.</p>  | Yes   |
| Operating Segments                             | <p>FMPG have included disclosure in the accounts that it monitors performance through a single operating segment at the Group / Parent level. Effectively oversight of the overall delivery of vessels. In accordance with the FReM, the financial statements should include disclosure of performance consistent with internal reporting which we would consider to be at the contract / vessel level.</p>                                 | No – We are satisfied that this is not material to the users of the accounts. |

There were also minor presentational changes recommended to management. These are not considered material to the accounts.

## 2. Recommendations from 2021/22 audit

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

### Recommendation

### Agreed management response

#### 1. Business Plan

FMPG and Scottish Government have agreed the end of March 2023 as the deadline for an agreed business plan. This will be informed by the work of the consultants commissioned by Scottish Government. FMPG management have started to explore future scenarios, and what each scenario including what these scenarios would mean for the workforce, income, and risks

In order for FMPG to produce a clear business plan the Board and management need clarity of the level of investment from Scottish Government over the course of 2023/24 and beyond. Without investment, FMPG may not be able to compete in tenders for new work, or continue to explore options.

**Management response:** Management will develop the final draft for discussion during March.

**Action owner:** Chief Executive.

**Timescale for implementation:** FMPG Board approval by 31 March 2023. Scottish Government to approve in the first half of 2023 thereafter.

#### 2. Going concern uncertainty

At the point of concluding the audit there were risks and uncertainties around FMPG's going concern consideration, for at least the 12 month period from the date of signing the audit report (January 2023). These risks and uncertainties are drawn out in FMPG's annual report and accounts. In the last quarter of the 2022/23 financial year, it is important that FMPG and Scottish Government work together to resolve these uncertainties, giving clarity to FMPG on the delivery of 801 and 802, per contract, and the future plans for FMPG (commercial subsidiary). This clarity is needed for the business plan and will support the FMPG Board in further considering the organisations ability to continue as a going concern.

**Management response:** The aim is to close the budget uncertainties within the first half of the 2023 year.

**Action owner:** Chief Executive.

**Timescale for implementation:** By 30 June 2023.



## Recommendation

### 3. Nature and structure of FMPG as a public sector entity

FMPG has been established as a non-departmental public body (NDPB) of Scottish Government. The Framework document, on the FMPG website, took time to get agreed, with several iterations. This sets out that FMPG must comply with the SPFM and largely mirrors that of other NDPBs. It is recommended that this is re-reviewed, in the context of the business plan and future direction. There will be a cost to FMPG in being able to fully comply with the Framework document, and SPFM as currently written and whether this cost is justifiable, in the short-term is something that should be revisited.

Should the intention be that FMPG operates, in full, as an NDPB, compliance with SPFM will be required and the FMPG management team will need suitable support, in complying, recognising the commercial background of the leadership team, rather than of a public sector background.

### 4. Value for money assessment

In discussions with Scottish Government it was noted that FMPG like all other public sector organisations have an obligation to demonstrate and evidence value for money in all its activities, including financial spend. This is also noted in the Accountable Officer letter formally issued by Scottish Government, to the Chief Executive, setting out their responsibilities. The letter issued to the Chief Executive of FMPG is the standard Accountable Officer letter for public sector entities.

Clarity needs to be given to FMPG on what value for money means in the context of FMPG, and how FMPG will be assessed as delivering VFM. Given the increasing costs of delivering 801 and 802, compared with planned, there is a recognition, looking at costs to outcome, this won't represent VFM. Therefore, what is a suitable measure and benchmark.

## Agreed management response

**Management response:** This will be discussed with Scottish Government, in tandem on action point 2.

**Action owner:** Chief Executive and Scottish Government

**Timescale for implementation:** End of June 2023

**Management response:** This will be discussed with Scottish Government, in tandem on action point 2.

**Action owner:** Chief Executive and Scottish Government

**Timescale for implementation:** End of June 2023

## Recommendation

### 5. Pay arrangements and KPI frameworks

The framework document, as related to pay and FMPG, should be clarified, between FMPG and Scottish Government. In particular, whilst we note FMPG fall out with Scottish Government pay policies, the Framework document implies, that FMPG should still apply certain pay practices and where they do not, approval sought by Scottish Government in advance of payments.

Recognising the employment contracts (Senior Management and Chief Executive) contain a potential performance related bonus FMPG and Scottish Government should agree a suitable performance framework to evaluate performance, and whether the bonus can be paid, aligned to the performance metrics agreed. It is noted that a framework was proposed and discussed at the FMPG Remuneration Committee in November 2022. This would, as we understand it, need to be approved by Scottish Government.

Any performance that is paid, needs to be subject to appropriate governance, and be transparent in decision making, and subject to independent review and challenge, within FMPG and Scottish Government as appropriate.

Lastly, it should be clear between FMPG and Scottish Government, on how salaries for FMPG are determined, what they are benchmarked to, and when Scottish Government approval is required, and how this will be evidenced by FMPG.

### 6. Register of interests

FMPG should establish a formal register of interests to capture FMPG Board Members and the Senior Management teams declared interests, and this should be reviewed and updated where required. This will then support the review of related parties required, under IAS 8, to support disclosure in the annual report and accounts.

## Agreed management response

Management response: Pay and performance has been considered by FMPG at the Remuneration Committee in November 2022. This is being discussed with Scottish Government and approval sought.

Action owner: Chief Executive and Board Chair

Timescale for implementation: End of June 2023.

Management response: Agreed.

Action owner: Director of Finance/Board administration team.

Timescale for implementation: End of March 2023 to support the 2022/23 Financial statements.

# 3. Follow up of 2020/21 recommendations

We set out below our follow up on our prior year audit recommendations.

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## 1. Valuation of property, plant and equipment

The FREM requires operational property, plant and equipment to be held at current value. During the audit Management obtained an independent valuation of land and buildings from Graham & Sibbald. Our audit testing found that the valuation exercise did not cover all assets which we would have expected to be considered. In particular it did not cover: leased property at Cartsdyke and car parks at the yard. Management have sought subsequent assurances that the valuation of these assets would not materially differ from the current carrying value. However, we recommend that Management ensure arrangements are in place to ensure values continue to be reviewed with sufficient regularity to ensure they reflect current value. In addition, the valuation covers land and buildings, Management should consider whether material items of plant and equipment that are held for a longer period, should be subject to valuation.

**Initial Management response:** Agreed. Will be considered in the 2021/2022 Valuation considerations

**Follow up:** COMPLETE

Management have obtained a formal valuation report from Graham & Sibbald LLP for their leased assets, confirming the value of the asset as at 31<sup>st</sup> March 2022. This has allowed them to conclude that these assets are held at a value that is free from material misstatement

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## 2. Strategic Planning

Management have a potential future orders / tender pipeline. The pipeline and project planning in place as well as investment in infrastructure evidences strategic planning. However, there is an opportunity develop, working in conjunction with the Scottish Government, a medium to longer term strategic plan, underpinned with a financial strategy. This should provide clarity around the future strategic direction of the organisation, including those of the various subsidiary companies.

**Initial Management response:** Management recognises and agrees with the recommendations set out in the proposed Action Plan. The Audit and Risk Committee work programme has included actions to address these issues and implement the recommendations. The work programme is currently being reviewed and revised to reflect progress, and prioritisation of completing outstanding actions.

**Follow up:** OUTSTANDING

During 2021/22 FMPG continued to explore future work, beyond 801 and 802. A business plan is not yet formally in place, with a deadline of 31 March 2023 agreed with Scottish Government as a date for producing and agreeing the business plan. This will be prepared by FMPG, in discussion with Scottish Government and it is expected the ongoing review commissioned by Scottish Government will inform the business planning. During the year, FMPG have worked up the investment required in the Yard, initially, to support its business plan.

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# 3. Follow up of 2020/21 recommendations

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## 3. Governance and transparency

While operational delivery is clearly a key focus for the organisation, it will be important over the coming year that sufficient resources are in place to support the development of effective governance, risk and control arrangements and the delivery of the Audit and Risk Committee work plan. Specifically, the establishment of robust corporate risk management arrangements and an internal audit function. Overarching this should be the agreement of the Framework document with Scottish Government (currently in draft). In addition, as a non-departmental public body (NDPB) FMPG should look at enhancing the transparency of performance and other information (including timely publication of minutes) to support public scrutiny while managing commercially sensitive information.

**Initial Management response:** The Audit and Risk Committee work programme has included actions to address these issues and implement the recommendations. The work programme is currently being reviewed and revised to reflect progress, and prioritisation of completing outstanding actions.

### Follow up: **IN PROGRESS**

A focus of the Audit Committee in year has been the wider FMPG control environment, and how FMPG can comply with the Framework Document and the SPFM. Work has been done to investigate internal audit and initial discussions have been held. On reflection, as reported in this report, due to the unique nature of FMPG careful consideration should be given, on whether FMPG is required to comply with all aspects of the SPFM. Looking ahead, and depending on the future of this entity, additional cost (and time) may be incurred, to allow FMPG to comply with the SFPM, for what is a short-term requirement. One example of this could be the cost of internal audit and evaluating whether this cost, is a necessarily cost just now, in the context of FMPG's current operations. See commentary in this report, and the recommendations for 2021/22 for additional commentary.

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# 3. Audit fees and independence

## External Audit Fee

| Service  | Fees £        |
|--|---------------|
| External Auditor Remuneration                    | 37,000        |
| Pooled costs                                     | 8,560         |
| Contribution to Audit Scotland costs             | 1,760         |
| Contribution to Performance Audit and Best Value | Nil           |
| <b>2021/22 Fee*</b>                              | <b>47,320</b> |

## Fees for other services

| Service  | Fees £ |
|--|--------|
| We confirm that for 2021/22 we did not receive any fees for non-audit services | Nil    |

## 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](mailto: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 \[grantthornton.co.uk\]](https://www.grantthornton.co.uk/transparency-report-2021)

- \* The final audit fee will be agreed on conclusion of the audit. Additional input has been required due to the going concern discussion and also the additional work on the deferred tax, where we have used our commercial audit colleagues to support our review of disclosures.

## Independence and ethics

- We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention.
- We have complied with the Financial Reporting Council's Ethical Standards and therefore we confirm that we are independent and are able to express an objective opinion on the financial statements.
- We confirm that we have implemented policies and procedures to meet the requirements of the Financial Reporting Council's Ethical Standard and we as a firm, and each covered person, confirm that we are independent and are able to express an objective opinion on the financial statements.

# 4. 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.

| <b>Our communication plan</b>   | <b>Audit Plan</b> | <b>Audit Findings</b> |
|---|-------------------|-----------------------|
| 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 FMPG's 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   |                   | •                     |

