



Scottish Canals

External Audit Plan for the financial year ending 31 March 2020

Final External Audit Plan to the Audit and Risk Committee

28 February 2020

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Our audit at a glance

An audit underpinned by quality



Scottish Canals financial statements are prepared in accordance with the Transport Act 1962 and directions issued thereunder by Scottish Ministers. The Accounts directions require Scottish Canals to prepare accounts in accordance with International Financial Reporting Standards, and Companies Act 2006. Scottish Canals financial operating model is more reflective of central government body than a public corporation and Management have been in discussions with Scottish Government to consider the suitability of the Accounts Direction and accounting framework that is adopted, including potential adoption of the HM Treasury Financial Reporting Manual (FRoM). Adoption of the FRoM could have significant implications on Scottish Canals financial statements and budgetary arrangements.



Planning materiality is set at **£460,000**, being approximately 1.7% of revenue based on 2019/20 budget. This is based on our assessment of what misstatement either individually or in aggregate could be significant as to be misleading to the users of financial statements. We will apply a lower materiality threshold on review of the Remuneration report to ensure that remuneration has been disclosed appropriately. We will revisit our materiality throughout our audit including updating to reflect the unaudited financial statements.



Significant audit risks are: management override of controls; risk of fraud in revenue recognition as set out in International Standards on Auditing (ISAs UK); the risk of impairment in inventories (work-in-progress) and investment property and, defined benefit pension scheme liabilities.



Our audit is undertaken in accordance with the Audit Scotland Code of Audit Practice and reflects the wider scope nature of public audit. Through our audit planning we have identified wider scope risks reflecting the organisation's **financial sustainability** challenges in ensuring sufficient investment to support and maintain the canals' infrastructure and ensuring Scottish Canals can demonstrate **value for money**, particularly around strategic investment decisions.



Management are in the process of developing a new Corporate Strategy 2020-23. An area of focus over the term of the strategy will be how Scottish Canals aim to address the funding gap and backlog maintenance pressures in the Canals network and the strategic direction taken by Scottish Canals as it looks to manage these pressures. Management have estimated that it currently has a repair maintenance backlog of over £70 million.



IFRS 16 was effective for accounting periods beginning on or after 1 January 2019. The new standard sets out the principles for the recognition, measurement, presentation and disclosure of leases and replaces the previous standard IAS 17. The adoption of IFRS 16 in 2019/20 could have a significant impact on Scottish Canals and it is critical that management have a clear assessment of lease and lease type arrangements to ensure these are appropriately reflected within the financial statements.

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Overarching principles of our audit

Our audit is risk based and undertaken in accordance with the International Standards on Auditing (ISAs) (UK) and the Audit Scotland Code of Audit Practice 2016 ('the Code'). Our overall objective is a effective, quality-focused external audit which adds value through wider insights and challenge. Our audit foundations are:

- ✓ professional scepticism
- ✓ a focus on audit risks and key areas of management judgement
- ✓ Delivering a quality audit through our experienced public sector audit team, use of data analytics to focus our audit and understanding of the organisation
- ✓ clear and upfront communications, with regular communication during the year
- ✓ reporting with focused actions which will support you in improving your controls/operations

External Audit plan

The External Audit Plan summarises our responsibilities in accordance with ISAs and the Code:

- Respective responsibilities;
- Our audit process and timeline
- Materiality
- Our risk based audit approach to the audit of the financial statement
- Our wider scope responsibilities including those in relation to the four wider audit dimensions prescribed in the code: Financial management; financial sustainability; governance and transparency; and, value for money.

Continuous improvement and adding value

Our aim is to add value to Scottish Canals through our external audit work. This will be delivered through delivering a high-quality audit. Specifically for Scottish Canals we will also undertake the following arrangements:

Continuous learning and development: We have discussed with the finance team opportunities to develop our audit approach to ensure we deliver an efficient and effective audit approach. This will include meetings with finance team to discuss the financial statements and the supporting information we will require during our audit.

Robust and effective audit methodology: Our ISA compliant audit methodology is tailored to focus audit resource on significant risk areas and key estimates and judgements.

Audit appointment

The Auditor General for Scotland is an independent Crown appointment, made on the recommendation of the Scottish Parliament. The Auditor General is independent and not subject to control of any member of the Scottish Government or the Parliament. The Auditor General is responsible for securing the audit of the Scottish Government and most public bodies, including NHS bodies in Scotland, and reporting on their financial health and performance.

Audit Scotland is an independent statutory body that provides the Auditor General with the services required to carry out her statutory functions, including monitoring the performance of auditors through a quality control process.

The Auditor General has appointed Grant Thornton UK LLP as external auditor of Scottish Canals for the five year period 2016/17 to 2020/21.

Our team

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The audit will be supported by a team of qualified and part qualified accountants from our public sector audit team. Where required we will use other audit experts, including Public Sector technical accounting team to support our audit.

Respective responsibilities

As set out in the Code of Audit Practice there are a number of key responsibilities you as an organisation are responsible for, and others, as appointed auditors we are responsible for. These are summarised below:

Area	Scottish Canals' Responsibilities
Corporate governance	<ul style="list-style-type: none"> Establishing arrangements for proper conduct of its affairs Legality of activities and transactions Monitoring adequacy and effectiveness of arrangements (inc role of those charged with governance)
Financial statements	<ul style="list-style-type: none"> Preparing financial statements which give a true and fair view of their financial position Maintaining accounting records and working papers Putting in place systems of Internal Control and maintaining proper accounting records Preparing and publishing an annual governance statement, management commentary and remuneration report Effective systems of internal control as well as financial, operational and compliance controls – supporting achievement of objectives and secure value for money
Financial position	<ul style="list-style-type: none"> Proper arrangements to ensure financial position is soundly based and responsibility to ensure arrangements secure Value for Money
Fraud and error	<ul style="list-style-type: none"> Establishing appropriate arrangements for prevention and detection of fraud, error, irregularities, bribery and corruption and affairs are properly managed

Our responsibilities



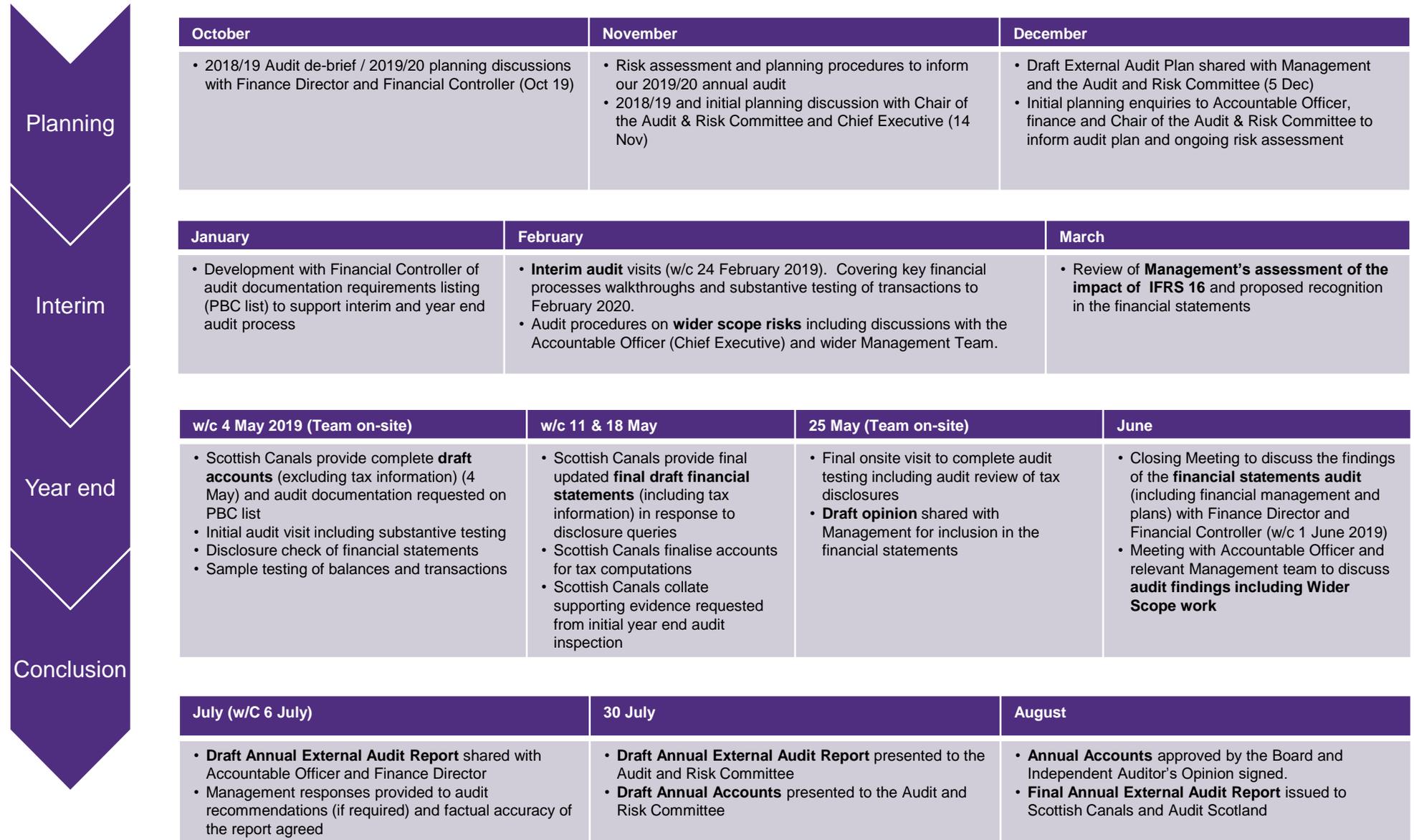
- Undertake statutory duties and comply with professional engagement and ethical standards
- Provide an ISA compliant opinion on financial statements and where appropriate regularity of transactions
- Review and report on, as appropriate, other information eg annual governance statements, management commentary, remuneration reports
- Notify the Auditor General when circumstances indicate a statutory report may be required
- Demonstrate compliance with wider public audit scope in accordance with Audit Scotland's Code of Audit Practice and applicable guidance
- Contributing to Audit Scotland Performance Reports
- Providing regular updates to Audit Scotland to share awareness of current issues across our audit clients
- Notify Audit Scotland of any cases of money laundering or fraud
- Contribute to National Fraud Initiative (NFI) report
- Contribute to Audit Scotland technical guidance

How do we do this in practice



- By reviewing and providing judgements and conclusions on Scottish Canals arrangements including those across the wider scope of audit dimensions.
- Suitability and effectiveness of corporate governance arrangements in year
- Financial position and arrangements for ensuring financial sustainability in the medium to longer term
- Review of other information in line with our knowledge and understanding of Scottish Canals
- Ongoing dialogue and engagement with Audit Scotland during the year
- Providing quarterly fraud updates to Audit Scotland and information on any money laundering
- Consider and report on audited bodies participation in NFI
- Support Audit Scotland through engaging in technical guidance publications

Audit process and timeline



Wider reporting responsibilities

Our planned audit timeline is detailed below. In accordance with the Code of Audit Practice and audit Scotland Planning Guidance, we are required to undertake and report on a range of areas. Below we summarise the key outputs to Scottish Canals and Audit Scotland during 2019/20.



National Fraud Initiative

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

During 2018/19 we identified that Scottish Canals arrangements for participating in the NFI process required improvement, including incorporating the process into policies and procedures and formal documentation of the outcome of investigations.

All matches should have been fully investigated by 30 September 2019 and the results recorded on the NFI system. During 2019/20 we will consider the progress made by Scottish Canals in investigating matches and recording outcomes from these investigations. As noted above, we will report on our findings to audit Scotland through the NFI questionnaire by 28 February 2020.

Materiality



We undertake your audit in accordance with International Standards on Auditing (UK) (ISAs) and the Audit Scotland Code of Audit Practice (May 2016). On an annual basis we are required to give an opinion as to whether the Financial Statements:

- give a true and fair view
- have been properly prepared in accordance with relevant legislation and standards
- audited parts of the Directors' report have been prepared in accordance with the guidance
- regularity of expenditure and income
- the wider information contained in the financial statements e.g. Strategic Report; Directors Report and Governance Statement is consistent with our audit knowledge and the financial statements

Basis for materiality

We determine financial statement materiality based on a proportion of the total revenue. This approach is consistent with our audit methodology. We have determined Scottish Canals' materiality to be **£460,000**, which equates to approximately **1.7%** of your budgeted total revenue for the year (based on final revised budget in March 2019).

Performance materiality

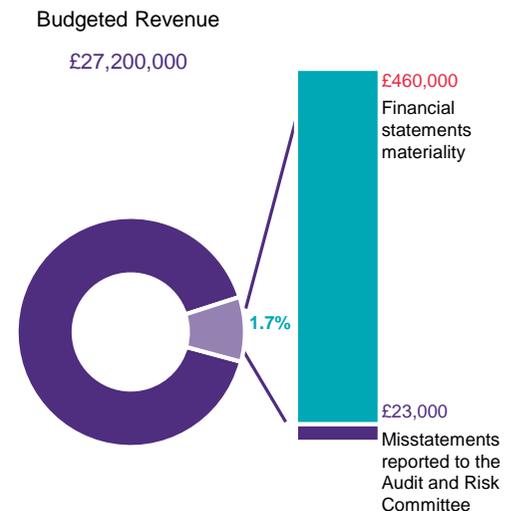
Performance materiality represents the amount set for the financial statements as a whole to reduce the probability that the aggregate of uncorrected and undetected misstatements exceed materiality. Based on our audit experience we have retained this for 2019/20 at **75%**, being **£345,000**. Performance materiality determines those accounts which testing will be undertaken on and the level of sample testing performed where applicable. Performance materiality is set at 75% of overall materiality. This is consistent with the prior year reflecting our audit knowledge and understanding with no material adjustments in the prior year.

Our materiality reflects our professional judgement of the magnitude of an omission or misstatement that, individually or in the aggregate, could reasonably be expected to influence the economic decisions of the users of the financial statements. We will apply a lower materiality threshold on review of the Directors' Remuneration report to ensure that remuneration has been disclosed appropriately.

We will update our materiality based on the unaudited 2019/20 financial statements. During the course of our audit engagement, we will continue to assess the appropriateness of our materiality.

Reporting to those charged with governance

Whilst our audit procedures are designed to identify misstatements which are material to our opinion on the financial statements as a whole, we nevertheless report to the Audit Committee any unadjusted misstatements of lesser amounts to the extent that these are identified by our audit work. Under ISA 260 (UK) 'Communication with those charged with governance', we are required by auditing standards to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. We have determined this threshold to be **£23,000**, being 5% of overall planning materiality.



A risk based audit methodology

A core part of audit planning is understanding Scottish Canals of the wider operating environment. This is our fourth year as the external auditors of the organisation appointed under the Audit Scotland framework.

Through our audit planning procedures we consider a range of factors to assess the risk of material misstatement to the financial statements. Significant risks are defined by ISAs (UK) as risks that, in the judgement of the auditor, require special audit consideration. In identifying risks, audit teams consider the nature of the risk, the potential magnitude of misstatement, and its likelihood. Significant risks are those risks that have a higher risk of material misstatement. Our risk assessment includes the following;

Consideration of critical accounting estimates including the valuation of investment property and work-in-progress and the recognition of defined benefit pension scheme liabilities

Assessment of inherent risk factors including changes in the organisation's activities and environment

Understanding of entity level controls and the control environment, including IT controls.

Financial and operational performance during the year, including financial performance against plan

Identified Significant risks

- Risk of fraud in Revenue recognition
- Management override of controls
- Defined benefit pension schemes' liabilities
- Valuation of investment property and work-in-progress

We continue to assess the risk of material misstatement and our response to these risks throughout our audit. Within our Annual Audit Report we will report to you the conclusions from our audit procedures over these risks, including any further risks identified or changes to our planned audit response.

Accounting Framework

Scottish Canals financial statements are prepared in accordance with the Transport Act 1962 and directions issued thereunder by Scottish Ministers. The Accounts directions require Scottish Canals to prepare accounts in accordance with International Financial Reporting Standards (as adopted by the EU), and Companies Act 2006. While Scottish Canals generate over 50% of their own revenue from commercial enterprises, the organisation remains dependent on Scottish Government revenue funding to meet operational costs. This is more reflective of central government body than a public corporation. The new corporate strategy expected to be finalised in 2020 will shape the future vision for Scottish Canals. Scottish Canals have been in discussions with Scottish Government to consider the suitability of the Accounts Direction and accounting framework that is adopted, including potential adoption of the HM Treasury Financial Reporting Manual (FReM). Adoption of the FReM could have significant implications on Scottish Canals financial statements and budgetary arrangements, including the requirement to revalue assets and fundamental changes in how Scottish Government funding is recognised. Our audit planning has been conducted on the basis that the existing financial reporting requirements will remain unchanged during 2019/20. We will continue to monitor the outcomes Scottish Canals' discussions with Scottish Government and continue to assess the impact both on our audit approach and wider implications, if any, on the financial statements.

Significant financial statement risks

Risk area	Areas of focus	Description of risk
Risk of fraud in revenue recognition	Income from Contracts (Occurrence) Receivables (Existence, Valuation)	<p>As set out in ISA 240 there is a presumed risk that revenue may be misstated due to improper recognition of revenue. In 2018/19, Scottish Canals received £8.1 million in grant-in-aid funding from the Scottish Government. While material, we consider this funding to be well forecast and directly agreed to Scottish Government funding letter and draw down. We therefore consider the opportunity and incentive to manipulate this revenue stream as low and rebut the presumed risk around revenue recognition over revenue resource allocation. Similarly, as interest received from investments and interest income is unlikely to material or represent a material risk of misstatement we do not consider these revenue streams at risk of material misstatement through fraud in revenue recognition.</p> <p>Scottish Canals generates other revenue through a range of sources including the sale of goods (water, utility and retail sales) and rendering of services. These represent material revenue streams. We therefore consider the risk of fraud in revenue recognition to be present in material revenue streams recognised within Sale of goods and Rendering of services, being over £9.4 million of revenue in 2018/19.</p>
Audit Response		
<ul style="list-style-type: none"> • Walkthroughs of the controls and procedures over sales of goods including water, utility and retail sales, and rendering of services. • Perform substantive testing (at an elevated risk level) over income recognised in the year where there is an increased risk of fraudulent recognition • Evaluation of the existence of receivables balances held at 31 March 2019 through agreeing balances held to invoices and/or other supporting records. • Perform income cut-off procedures and substantive testing over pre and post year end balances, over non grant in aid income. • A focus on recoverability of balances through agreeing a sample of debtor balances (at an elevated risk level) and agreeing to post year end cash receipt. 		

Significant financial statement risks

Risk area	Areas of focus	Description of risk
Management override of controls	Journals Accounting Estimates	<p>As set out in ISA 240 there is a presumed risk that management override of controls is present in all entities. This risk area includes the potential for management to use their judgement to influence the financial statements as well as the potential to override Scottish Canals' controls for specific transactions.</p> <p>We consider areas where there is insufficient segregation of duties or undue influence of individuals within the organisation that could circumvent controls. In particular, for a public sector organisation, there is a risk that oversight and governance controls are not operating effectively, resulting in failure to prevent or detect inappropriate management override of controls.</p> <p>We consider those key judgements that are most susceptible to significant audit risk of management override are those over income and expenditure recognition transactions around the year end. These are areas where management has the potential to influence the financial statement through estimate and judgement.</p>
Audit Response		

Accounting estimates:

In assessing the risk of management override, consider those key accounting estimates and judgements that could impact on the organisations financial results and where there is an inherently increased risk of fraudulent misstatement or where management bias could result in a material misstatement. A key area of focus is understanding wider entity level controls in place at the organisation including budget monitoring, governance and oversight arrangements in place at Scottish Canals over key areas of estimation and judgement and underlying financial transactions. In response to the significant audit risk we will:

- consider the design of controls in place over key accounting estimates and judgements including, where applicable, how internal and external experts have been engaged to arrive at the accounting estimate or judgements and documentation to support the basis of the estimate.
- Review accounting estimates for management bias / indication of fraud that could result in material misstatement.

Journals testing:

We will use our data analytics tool to support our evaluation of journal transactions during the year. In response to the significant risk we will:

- Assess the design of controls in place over journal entries, including how these are prepared, authorised and processed onto the financial ledger;
- Will risk assess 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 will test these journals to ensure they are appropriate and that suitably recorded in the financial ledger and the financial statements;
- We will perform targeted testing of transactions around the financial year end reviewing those journals are large or otherwise appear unusual to understand the rationale for the transaction.

Significant financial statement risks

Risk area	Areas of focus	Description of risk
Valuation of assets (inventory and investment property)	Inventory – WIP (Valuation) Investment property (valuation)	<p><i>Inventory</i></p> <p>Scottish Canals have an ongoing development (Dundas Hill project) which has involved the acquisition of land and remediation of the site and initial development works. As at 31 March 2019, the expenditure on the site totalled £7.3 million. Scottish Canals recognise the development in accordance with International Accounting Standard 2: <i>Inventory</i>, as inventory (work-in-progress) on the basis that the asset is held for sale in the ordinary course of business (this is not the first development and sale that Scottish Canals have undertaken) and that expenditure incurred supports the production of the site for sale. There is a risk that the value of inventory may be overstated due to the recoverable value of development through sale being lower than current carrying amount (cost). This could be through market conditions or changes in planned usage of the site that could impact on recoverable amount. Consequently we consider there to be a significant risk of material misstatement in the carrying value of inventory.</p> <p><i>Investment property</i></p> <p>As at 31 March 2019, Scottish Canals held £16 million of investment properties, held at their fair value, being market value. On an annual basis Scottish Canals obtain an independent valuations of the assets held based on a range of assumptions around market price or yields depending on the type of property held. In addition, we are aware that Scottish Canals has entered into a number of transactions involving investment property during the year which significantly impact on carrying values. Given the material value of investment property held and the judgement and estimation in the valuation, we consider there to be a significant risk of material misstatement in the carrying value of investment property.</p>

Audit Response

Inventory

We will test expenditure during the year on the Dundas Hill development to ensure that this continues to relate to the development of the site to support sale and in line with overall project plan. We will review Managements' latest plans for the development to ensure that the accounting treatment under IAS 2 remains appropriate. We will assess Management's assessment of the recoverable amount (from sale) from the development to determine if this is supported by up to date observable market information to demonstrate that the carrying value will be fully recovered through sale and that there is no indication of impairment.

Investment property

We will consider the suitability of the valuation methodology to ensure consistent with IAS 40: *Investment Property*

We will consider the independence, objectivity and suitability of the valuer as Management's expert in undertaking the valuation

We will understand the processes and controls in place around the valuation of investment property, including instructions provided to the independent valuer

We will review the appropriateness of the assumptions adopted by the valuer, including where relevant, reference to third party information (indices etc).

Significant financial statement risks

Risk area	Areas of focus	Description of risk
Defined benefit pension scheme	Defined benefit pension scheme (valuation)	<p>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: <i>Employee Benefits</i>, Scottish Canals is required to recognise its share of both scheme's assets and liabilities on the statement of financial position. As at 31 March 2019 Scottish Canals had pension fund liabilities of £864,000.</p> <p>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.</p>
Audit Response		
<ul style="list-style-type: none"> • Walkthroughs of the controls and procedures over the valuation of pension scheme liabilities, including information and instructions provided to the pension funds and actuaries • Understanding the arrangements in place at the Scottish Canals for reviewing the assumptions adopted by the actuaries and suitability of these for the organisation • We will consider the suitability and reasonableness of the underlying assumptions adopted by the actuaries in arriving at the defined benefit pension scheme liabilities, including ensuring underlying data used is appropriate in informing the valuations • Reviewing the underlying data supporting the valuations to ensure these are consistent with the Scottish Canals' underlying records 		

Other audit areas

Going concern considerations

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

We will review management's assessment of the going concern assumption and evaluate the disclosures in the financial statements, alongside our assessment based on substantive testing and audit procedures.

Working with Internal Audit

The Auditing Standards Board's version of ISA (UK) 610 “Using the work of internal auditors” prohibits the use of internal audit to provide “direct assistance” to the audit. Our approach to the use of the work of Internal Audit has been designed to be compatible with these requirements.

During 2019/20, we engage with Internal Audit to confirm any awareness of fraud or suspected fraud. Where Internal Audit have identified specific material deficiencies in the control environment that would create a risk of material misstatement to the financial statements, we will consider adjusting our testing so that the audit risk is covered by our work.

Internal control environment

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

- Consider procedures and controls around related parties, journal entries and other key entity level controls including controls to mitigate Management override of controls.
- Perform walkthrough procedures on key controls around identified risk areas including operating income, payroll expenditure, other expenditure, journal entries, IAS 19 pension accounting and review over work-in-progress.

International Financial Reporting Standards 16: Leases (IFRS 16)

IFRS 16 was effective for accounting periods beginning on or after 1 January 2019. The new standard sets out the principles for the recognition, measurement, presentation and disclosure of leases and replaces the previous standard IAS 17. IFRS 16 introduces a single lessee accounting model aimed at providing a fairer representation of a lessee's assets and liabilities and disclosures around these. Under IFRS 16, the lessee's recognises assets and liabilities with a term of more than 12 months, unless the underlying asset is of low value. In practice, this is likely to result in lease or lease type arrangements associated assets and liabilities being recognised in the financial statements of the lessee, where these may have previously been treated as operating leases where there was no asset or liability recognised and only an annual lease charge through expenditure.

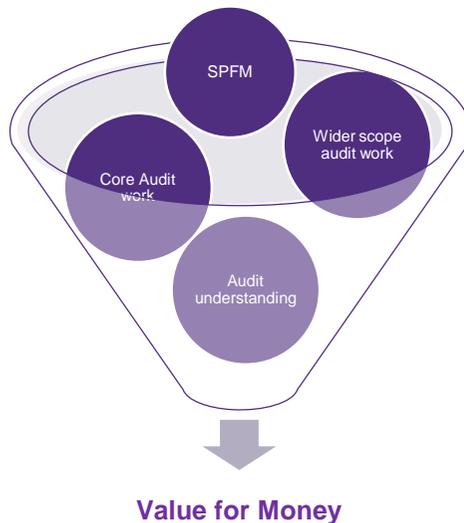
Scottish Canals will adopt IFRS 16 in the current year with the full year accounting impact reflected within the 2019/20 financial statements. It is critical that management have a clear assessment of lease and lease type arrangements to ensure these are appropriately reflected within the financial statements. We will review the progress made by Scottish Canals in identifying and evaluating leases against the new standard and confirm that these are appropriately disclosed in the financial statements during our year end audit.

Wider scope audit

Our responsibilities under Audit Scotland's Code of Audit Practice extend beyond the audit of the financial statements. The Code sets out four dimensions that frame wider scope audit work into identifiable areas. Alongside Value for Money, the audit dimensions set a common framework for our audit work and we review and conclude on the four dimensions and that there are organisational arrangements in place to secure Value for Money.



Wider scope approach



Our wider scope audit work is a **risk based** approach. It is built upon our understanding of the organisation and consideration of:

- Scottish Public finance Manual (SPFM) nine characteristics of Value for Money
- Our core audit work and audit knowledge
- Audit Scotland planning guidance

We consider each of these areas through our audit planning process. We summarise our planning consideration over the wider scope areas below, including where we have identified a significant wider scope risk, our planned audit response. We have also identified areas that we will continue to consider throughout our audit to allow us to conclude on the wider scope areas in our Annual Audit Report.

Wider scope audit dimensions

Financial sustainability

Management are in the process of developing a new Corporate Strategy 2020-23 and a critical area of focus of the strategy will be how Scottish Canals aim to address the estimated repair maintenance backlog of over £70 million in the canals network identified within the Asset Management Strategy. It is critical that Scottish Canals have a robust financial strategy that underpins the delivery of the Corporate strategy as well as supporting the organisation maintain the canals network and infrastructure.

Significant wider scope risk identified: Like many public bodies, Scottish Canals face financial challenges through rising pressures on payroll costs, as well as inflationary increases on other operating expenditure. With Scottish Government Grant-in-aid revenue funding not expected to increase significantly over the medium term, Scottish Canals continues to look to support options for maximising revenue. It is critical that the Scottish Canals' financial plans focus on both the immediate pressures of meeting the day to day operating and maintenance costs of the canals network, against a context of relatively static Government funding, as well as focusing on longer term strategic investment required to maintain the canals assets.

Audit
response

Response to wider scope risk

We will review the financial plans in place, including the scenarios set out, and how these align resources to the delivery of Scottish Canals' new corporate priorities. We will assess the extent to which the financial plan and corporate plans are developed recognising the short term financial pressures facing the organisation as well as the longer term challenges in terms of strategy investment required to maintain the canals assets.

Other wider scope procedures

In relation to broader financial sustainability we will continue to develop our understanding of Scottish Canals financial planning arrangements including workforce plans and how these developed both supporting and recognising the financial and operational challenges facing the organisation.

Wider scope audit dimensions

Financial management

During 2018/19, Scottish Canals incurred a deficit for the year before tax of £2.008 million. This included a loss on the revaluation of investment properties of £1.4 million. Scottish Canals operating deficit for 2018/19 was £0.918 million. The operating position reflects challenging financial pressures facing Scottish Canals. The original budget for 2018/19 forecast a surplus of £0.15 million.

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

Scottish Canals have recognised the need for effective management of cost base to align investment expenditure with revenue receipts. Within the 2019/20 Business Plan and financial plan, there is greater focus on cost base and planned phasing of expenditure. Given the financial pressures facing Scottish Canals, including rising cost pressures such as the required maintenance of the Canals infrastructure, and the level of uncertainty and volatility around some of the revenue streams, it is critical that Scottish Canals have close financial monitoring and oversight.

Scottish Canals are in the process of reviewing financial monitoring arrangements, including financial monitoring reports, to ensure there is suitable oversight and scrutiny of the costs incurred.

Audit
response

We have not identified any significant wider scope risks through our audit planning. We will continue to review Scottish Canals' financial management arrangements including the extent to which there is effective scrutiny over both operational spend as well as monitoring of income generated to ensure this was in line with budgets.

We will assess how Scottish Canals' financial monitoring arrangements develop during the year and how this supports effective scrutiny and challenge of financial performance during the year. Scottish Canals have a range of complex transactions, including investment property trades, defined benefit pension schemes as well as capital investments. We will assess the extent to which there is sufficient oversight and scrutiny over the financial performance of the organisation, both in terms of financial performance against revenue budget as well as investment returns.

Wider scope audit dimensions

Governance and transparency

Critical to the delivery of Scottish Canals' corporate plan will be clear leadership and accountability with effective governance arrangements in place. During 2018/19, there was significant changes across the Scottish Canals Board with the Chair of Scottish Canals being the only remaining member of the six person Board (including Chief Executive) from March 2018. While we recognise that a number of the departures were due to the end of the individuals period of appointment, the level of transition across the Board can adversely impact on the effectiveness of oversight and scrutiny, particularly during a critical period in developing a new corporate plan. During 2018/19, Internal audit raised a number of recommendations as to where Scottish Canals could enhance their governance and transparency arrangements. Our 2018/19 annual audit report also found weaknesses in governance arrangements during the year.

During 2019/20 Scottish Canals is undertaking an assessment of governance arrangements in place at the Board to ensure these are sufficient to provide effective oversight and leadership for the organisation as it faces into a challenging period. We understand the Chair of Scottish Canals' appointment has been extended by six months to help support the introduction of the new Corporate Plan.

Audit
response

We will consider the extent to which Scottish Canals have enhanced governance arrangements through acting upon the recommendations raised within the internal and external audit reports in 2018/19, as well as any opportunities identified through Management's own self-assessment to strengthen governance and transparency. We will look to evidence these improvements through audit review.

Wider scope audit dimensions

Value for money

One of the key core themes within Scottish Canals current Corporate Plan (2017-20) is increasing financial sustainability. This focuses on generating reliable sources of income from a growing range of canal related services and goods for which markets existed or can be developed. Critical to Canals financial strategy, was generating revenue through a wider range of investments and activities to support the required ongoing investment in the canals network. Subsequently, Canals have enter into a number of investments and often complex transactions.

Significant risk identified: *In the context of facing significant financial challenges in ensuring sufficient strategic investment to maintain the canals network, the effective use of resources is increasingly critical for Scottish Canals. It is critical that Scottish Canals can demonstrate value for money in the activities is undertakes, including decisions around investments. In particular, the extent to which strategic investments deliver the desired outcomes over the medium to short term.*

Audit
response

Response to significant risk: We will assess the extent to which Scottish Canals demonstrate value for money in its strategic investment decisions. In particular, we will consider the extent to which the Management and the Board consider the potential outcomes from strategic investment decisions, including option appraisal and cost/benefit analysis. We will consider the extent to which Scottish Canals monitor the outcome of strategic investment decisions and the extent to which they continue to support the delivery of corporate objectives.

Other wider scope procedures:

We will consider the extent to which Scottish Canals can demonstrate that they deliver value for money through the delivery of services, using resources efficiently and effectively to deliver outcomes. We will consider the extent to which the new Corporate Plan and underlying financial and operating plans supports the efficient and effective use of resources.

Audit deliverables

As set out in the Code of Audit Practice, as appointed auditors we have a number of wider reporting responsibilities beyond the audit of the financial statements. Below we summarise the key areas of work during our 2019/20 audit, including expected reporting under Audit Scotland's Code of Audit Practice and audit planning guidance (2018/19 Guidance on Planning the Audit)

Requirement	How we will report our findings
Annual accounts Perform an audit of the annual accounts and express and express specified audit opinion on them.	<ul style="list-style-type: none"> External audit plan External auditor's opinion on the financial statements Annual external audit report findings from our audit work of the financial statements
Wider scope audit dimensions Conclude and report on our assessment of the wider scope audit dimensions	<ul style="list-style-type: none"> Annual external audit report to Scottish Canals and the Auditor General for Scotland (audit findings report)
National Fraud Initiative Evaluate Scottish Canals' participation in the National Fraud initiative	<ul style="list-style-type: none"> Annual external audit report to Scottish Canals and the Auditor General for Scotland (audit findings report) Reporting participation to Audit Scotland including completion of NFI questionnaire
Emerging issues Communication of emerging issues to Audit Scotland and highlight any issues for potential statutory reports	<ul style="list-style-type: none"> Communicating throughout our audit emerging issues throughout the year
Correspondence queries Carry out preliminary enquiries into any correspondence relevant to the Board that is referred to Audit Scotland.	<ul style="list-style-type: none"> Providing responses to any correspondence received based on our audit knowledge and understanding and the results of any review as agreed with Audit Scotland
Money laundering and fraud Provide information on cases of money laundering or fraud	<ul style="list-style-type: none"> Reporting cases to the National Crime Agency of an instances of money laundering at the Board and reporting any identified frauds to Audit Scotland
Technical guidance Contribute to Technical Guidance Notes	<ul style="list-style-type: none"> Providing responses to Audit Scotland consultations on draft Technical Guidance notes for Auditors.

Appendices

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Appendix 1: Fees and independence

External Audit Fee

Service	Fees £
External Auditor Remuneration	39,550
Pooled Costs	6,990
Contribution to Audit Scotland costs	1,660
Contribution to Performance Audit and Best Value	-
2019-20 Fee	48,200

Fees for other services

Service	Fees £
At planning stage we confirm there are no non-audit fees. We undertake individual grant audit inspections for EU Grant funding for Scottish Canals. The total number of claims during 2019/20 have to be confirmed but maximum of 6	Nil £1,000 per claim

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.
- Full details of all fees charged for audit and non-audit services will be included in our Annual Report to those charged with governance at the conclusion of the audit.
- We confirm that we have implemented policies and procedures to meet the requirements of the Financial Reporting Council's Ethical Standards.
- We are required by auditing and ethical standards to communicate any relationships that may affect the independence and objectivity of the audit team.
- We can confirm no independence concerns have been identified.

Audit Scotland sets an expected fee for each audit carried out under appointment which assumes that the body has well-functioning controls, an effective internal audit service, and an average risk profile.

Audit Scotland reviews the expected fee each year and adjusts it if necessary based on auditors' experience, new requirements, or significant changes to audited bodies. The audit fee is calculated in accordance with guidance issued by Audit Scotland. In accordance with the Audit Scotland guidance we can increase the fee by up to 10% from the base fee set by Audit Scotland, depending on risk factors identified by us as your external auditors. We cannot reduce the fee from the baseline set out by Audit Scotland. For 2019/20 we have proposed an audit fee of £48,200 representing an uplift from the auditors remuneration baseline fee of £9,500. This reflects the additional work not incorporated into the baseline fee:

- IFRS 16 recognising full year inclusion in the accounts and increased risk of material misstatement.
- Recognising the asset base within Scottish Canals, we propose commissioning a valuations auditors expert to review and support the audit challenge of valuations (particularly around the valuation of Dundas Hill).
- The use of our own actuarial expert to independent review the assumptions contained within both of your defined benefit pension scheme actuarial valuations.

The fee is based on the following assumptions:

- supporting schedules to all figures in the accounts are supplied by the agreed dates and in accordance with the agreed upon information request list
- the scope of the audit, and Scottish Canals' activities will not change significantly from planned
- Scottish Canals will make available management and accounting staff to help us locate information and to provide explanations. We reserve the right to charge an additional fee for any additional work.
- We will only receive (and audit) 3 sets of accounts (1st draft; amended draft and final)
- Specific balances such as valuations of assets are supported by an independent specialist

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.

Appendix 2: Fraud arrangements

The term fraud refers to intentional acts of one or more individuals amongst management, those charged with governance, employees or third parties involving the use of deception that result in a material misstatement of the financial statements. In assessing risks, the audit team is alert to the possibility of fraud at Scottish Canals.

As part of our audit work we are responsible for:

- identifying and assessing the risks of material misstatement of the financial statements due to fraud in particular in relations to management override of controls.
- Leading a discussion with those charged of governance (for Scottish Canals this is assumed to be the Audit and Risk Committee) on their view of fraud. Typically we do this when presenting our audit plan and in the form of management and those charged with governance questionnaires.
- designing and implementing appropriate audit testing to gain assurance over our assessed risks of fraud
- responding appropriately to any fraud or suspected fraud identified during the audit.

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

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

Anti-Money Laundering Arrangements

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

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

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

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

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

In addition, as set out in the Audit Scotland Code of Audit Practice we have a role in reviewing Scottish Canals arrangements in response to the national fraud initiative exercise.

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

Appendix 3: Communication with those charged with those charged with governance

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

This document, The Audit Plan, outlines our audit strategy and plan to deliver the audit, while our Annual Report to those Charged with Governance will be issued prior to approval of the financial statements and will present key issues and other matters arising from the audit, together with an explanation as to how these have been resolved.

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

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		•



The contents of this report relate only to the matters which have come to our attention, which we believe need to be reported to you as part of our audit planning process. It is not a comprehensive record of all the relevant matters, which may be subject to change, and in particular we cannot be held responsible to you for reporting all of the risks which may affect the entity or all weaknesses in your internal controls. This report has been prepared solely for your benefit and should not be quoted in whole or in part without our prior written consent. 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.

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