

Public Audit Committee

20th Meeting, 2023 (Session 6), Thursday, 29 June 2023

The 2021/22 audit of Scottish Canals

Introduction

1. At its meeting today, the Public Audit Committee will take evidence from the Auditor General for Scotland (AGS) on his section 22 report, [The 2021/22 audit of Scottish Canals](#), which was published on 13 June 2023.
2. The AGS has prepared a note on the key messages from the report which, along with a copy of the report, can be found in the Annexe.
3. The Committee will decide any further action it wishes to take after it has taken evidence from the AGS.

**Clerks to the Committee,
26 June 2023**

Annexe

BRIEFING PAPER BY THE AUDITOR GENERAL FOR SCOTLAND

1. The Auditor General's report on the 2021/22 audit of Scottish Canals, made under section 22(3) of the Public Finance and Accountability (Scotland) Act 2000, was published on 13 June 2023.
2. The report brings to the committee's attention ongoing issues relating to the valuation of Scottish Canals' assets and the completeness and accuracy of its records and documentation. In [February 2022](#) the Auditor General for Scotland reported on similar issues raised in the 2020/21 audit of Scottish Canals.
3. For a second year in a row the auditors have issued a disclaimer on Scottish Canals' financial statements. A disclaimer is issued when an auditor is unable to provide an opinion on the financial statements because of insufficient appropriate audit evidence. The basis for the disclaimer on the 2021/22 financial

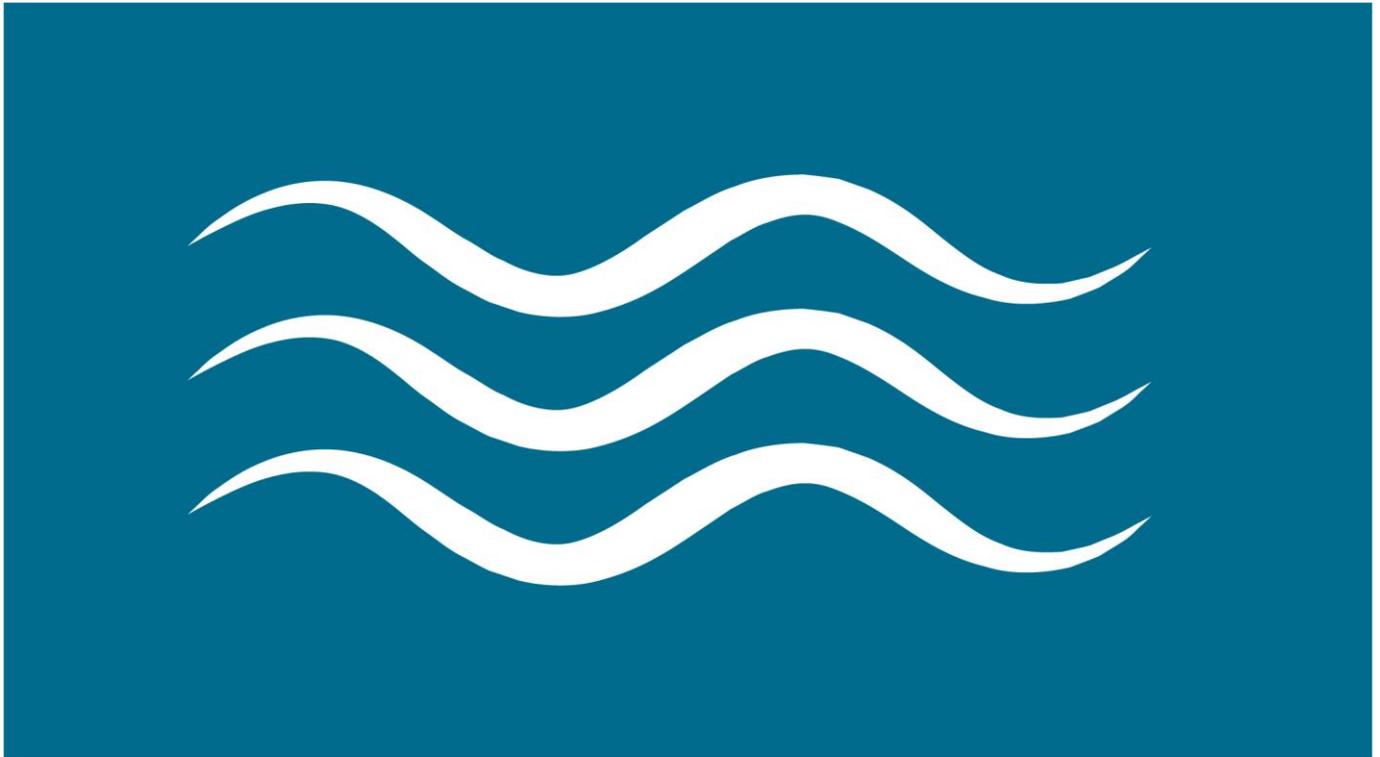
statements is in respect of Scottish Canals' £407 million valuation of its property, plant and equipment assets.

4. Key messages from the report are:

- The auditors have been unable to provide an opinion on the 2021/22 financial statements of Scottish Canals, due to a lack of sufficient and appropriate audit evidence. This reflects ongoing issues around the valuation of Scottish Canals' assets. These issues are significant enough to impact the financial statements as a whole. This means there is a lack of public assurance over Scottish Canals' financial position and performance, and the regularity of its transactions.
- Scottish Canals has faced considerable challenges adapting to the financial reporting and accounting framework required of it as a non-departmental public body. It has taken steps to address concerns raised by the auditors in 2020/21, including undertaking a new asset valuation. Its progress has been limited by underlying issues with the quality and accuracy of its documentation and data.
- Scottish Canals needs to develop an effective plan to resolve these ongoing issues as a matter of urgency and ensure it has the right capacity and expertise. It needs to establish robust asset records and invest in maintaining them to meet its statutory financial reporting responsibilities in a way that provides value for money. This is also important to support its asset management strategy and medium-term financial planning.

5. Scottish Canals needs to work closely with Transport Scotland, in its role as its Scottish Government sponsor division, to ensure that the implications of the accounting rules that Scottish Canals must work to are fully understood and reflected in the planned response. The auditors have set out a range of specific issues which need consideration by Scottish Canals to support improvement. These include ensuring all property, plant and equipment records are included in the fixed asset register; the maintenance of accurate and timely records; appropriate matching of expenditure recorded in the project management system to the fixed asset register; maintaining evidence of ownership and existence of assets; and determining an approach to re-evaluations.
6. The incoming auditors will engage closely with Scottish Canals to consider the pace and impact of activity being undertaken to address the issues raised. The Auditor General for Scotland will continue to monitor progress on these matters and report further in public as necessary.

The 2021/22 audit of Scottish Canals



AUDITOR GENERAL 

Prepared for the Public Audit Committee by the Auditor General for Scotland
Made under section 22 of the Public Finance and Accountability (Scotland) Act 2000

June 2023

The 2021/22 audit of Scottish Canals

1. I have received the audited annual report and accounts and the independent auditors' report for Scottish Canals for 2021/22. I am submitting these financial statements and the [auditors' report](#) under section 22(4) of the Public Finance and Accountability (Scotland) Act 2000, together with this report that I have prepared under section 22(3) of the Act.

2. My report brings to the Scottish Parliament's attention ongoing issues with the valuation of Scottish Canals' assets and the completeness and accuracy of its records and documentation. In February 2022, I reported on similar issues that the auditors had raised in their 2020/21 annual audit.

3. For a second year in a row, the auditors have issued a disclaimer on the financial statements. A disclaimer is made when the auditor is unable to provide an opinion on the financial statements due to a lack of sufficient appropriate audit evidence. The basis for this disclaimer is in respect of Scottish Canals' £407 million valuation of its property, plant, and equipment assets.

4. The financial value of these assets, and their significance for Scottish Canals achieving its key strategic objectives, has led the auditors to conclude that the issues with the property, plant and equipment balances affect the financial statements as a whole. As such the auditors were unable to conclude whether:

- the annual report and accounts give a true and fair view
- expenditure & income were regular (incurred in accordance with the applicable enactments & guidance)
- the Annual Report & Accounts are free from material misstatement
- adequate accounting records have been kept.

5. The auditors reported that they had not received all information and explanations required for their audit in relation to the property, plant and equipment balances. The auditors also raised concerns about the overall quality and timeliness of Scottish Canals accounting records and working papers. This has led to significant delays to the audit process.

Key messages

- The auditors have been unable to provide an opinion on the 2021/22 financial statements of Scottish Canals, due to a lack of sufficient and appropriate audit evidence. This reflects ongoing issues around the valuation of Scottish Canals' assets. These issues are significant enough to impact the financial statements as a whole. This means there is a lack of public assurance over Scottish Canals' financial position and performance, and the regularity of its transactions.
- Scottish Canals has faced considerable challenges adapting to the financial reporting and accounting framework required of it as a non-departmental public body. It has taken steps to address concerns raised by the auditors in 2020/21, including undertaking a new asset valuation. Its progress has been limited by underlying issues with the quality and accuracy of its documentation and data.
- Scottish Canals needs to develop an effective plan to resolve these ongoing issues as a matter of urgency and ensure it has the right capacity and expertise. It needs to establish robust asset records and invest in maintaining them to meet its statutory financial reporting responsibilities in a way that provides value for money. This is also important to support its asset management strategy and medium-term financial planning.

Background

6. Scottish Canals is responsible for the maintenance, management and development of Scotland's five canals, together with a number of associated land and property assets. Scottish Canals' principal activities include the maintenance of the 140-mile canal network; the provision of boating and leisure facilities, canal moorings and licences; and rental of land and property.

7. Scottish Canals consists of a board, made up of a chair, a vice chair¹ and one to four members appointed by Scottish ministers. Scottish Canals' chief executive, as accountable officer for the organisation, is accountable to the Scottish Parliament for ensuring its resources are used economically, efficiently, and effectively.

8. From April 2020, Scottish Canals has been required to meet the accounting and financial reporting framework applicable to non-departmental public bodies,

¹ The role of vice-chair is not currently filled.

a change from the previous position where it prepared its accounts as a public corporation². This meant that from 2020/21 Scottish Canals was required to account for its activities in accordance with HM Treasury's Government Financial Reporting Manual. This required Scottish Canals to change the way in which it values its assets. This was a substantial change to the body's accounting and financial reporting responsibilities.

9. In the 2020/21 audit, the auditors raised concerns about the valuations of Scottish Canals' assets, specifically aspects of its canal infrastructure. These concerns related to the appropriate expertise of the consultants which Scottish Canals had appointed to conduct the valuations and the valuations themselves. The auditors raised concerns about the quality and completeness of Scottish Canals' fixed asset register, finding that it lacked detail, included potential duplicate records, and assets which were incorrectly categorised. The degree of uncertainty in the valuations was deemed to be material to the audit. This resulted in the auditors issuing a disclaimer on the audit opinion, as there was insufficient evidence available to conclude that there were no material misstatements in the valuation of the assets.

10. I reported to the committee on these issues in [February 2022](#). I noted in my report that Scottish Canals intended to undertake a new valuation process of the canal infrastructure estate in its entirety, during 2022. I recognised that undertaking this would be a significant commitment but was necessary to provide sufficient evidence to support future judgements and estimates of asset valuations, and to support preparation of Scottish Canals' medium-term financial strategy and delivery of its asset management strategy.

Scottish Canals has made progress, but significant issues remain, resulting in a disclaimer on the 2021/22 audit opinion

11. Adapting to its new accounting and financial reporting responsibilities is not an easy undertaking, particularly given the scale and age of Scottish Canals' assets. The previous accounting and reporting requirements meant that much of the canal infrastructure had not been valued before. The unique nature of these assets also presents challenges as there is not an established source of comparable data for Scottish Canals to draw on. The change in accounting requirements, from those of a public corporation to a non-departmental public body, has taken place alongside a period of change in Scottish Canals' organisational focus and leadership. Scottish Canals has also faced workforce pressures, including high staff turn-over rates and recruitment challenges within its finance team.

12. Following the disclaimer on its 2020/21 accounts, Scottish Canals has taken steps to address the issues raised in relation to its asset valuations. This

² When established in 2012, it was intended that Scottish Canals would prepare its accounts as a public corporation, on the same basis as its predecessor body, British Waterways. Since then, Scottish Canals has not demonstrated the operating characteristics of a public corporation. Its status as a non-departmental public body was confirmed by the Office of National Statistics in 2019 when it carried out a review at the request of the Scottish Government.

includes significantly changing the asset valuation approach for 2021/22 compared to the prior year, with a substantial proportion of the canal infrastructure being valued for the first time. The focus of this activity has been to improve the completeness and accuracy of its fixed asset register.

13. A fixed asset register should provide an accurate record of the nature and condition of a body's assets to support its asset management strategy and medium-term financial planning. As reported through the 2020/21 audit, Scottish Canals' fixed asset register did not provide this. Understanding the condition, value and future costs of its canal infrastructure is fundamental to Scottish Canals delivering on its strategic objectives. During 2021/22, Scottish Canals has progressed work to categorise its assets and to break down its assessment of large assets into smaller components to allow these to be more easily valued. These are both important areas of progress to improve the accuracy of its fixed asset register and the valuations based on it.

14. Scottish Canals also contracted consultants, including specialist engineers, technical accountants, and qualified valuers, to support the reconstruction of its fixed asset register. The consultants developed a valuation model of the assets held by Scottish Canals for the year ending 31 March 2022. This involved the valuation of the canal network, which had not previously been included in the financial statements. These valuations were then used to update the closing balances for the previous two years.

15. The auditors were satisfied that the overall methodology taken to reconstruct the fixed asset register was reasonable. However, during testing the auditors identified a significant number of errors in the accounts and insufficient evidence to support the estimated £407 million valuation of the assets. The issues identified by the auditors largely reflect limitations in the underlying documentation and records held by Scottish Canals:

- Valuation of some assets were based on cost data provided by management, for example drawing on estimates or historic project costs, which could not be supported by evidence.
- There was a lack of data to support the assumption of 12-years operational life for some assets, when calculating their remaining value at the end of their useful life. This assumption can lead to large variations in overall valuations. For example, applying a ten-year assumption to these assets would lead to a reduction of over £21 million in the valuations.
- There were potential errors in the classification of some expenditure between capital or revenue, and a lack of evidence to support the classification of some spending as capital.
- There were errors in classification of some assets as being under construction, with some appearing to have become operational during the audit year. This would have required a revaluation of these assets. As this was not done, the auditors were unable to quantify the potential impact on the future value of these assets.

- The auditors had issues obtaining sufficient assurance over rights and obligations in respect of some assets, because of a lack of documentation on ownership.
- The reconciliation of the reconstructed closing balances to the figures in the draft accounts identified several errors. Scottish Canals made changes to information in its accounts to address these errors, but the auditors were unable to find evidence to confirm that the changes had been made accurately.
- The work to reconstruct the fixed asset register closing balance also led to a significant amendment of the prior year asset valuations reported in the 2020/21 accounts. Due to the scale of issue affecting the 2021/22 audit, the auditors did not consider it appropriate to test these prior year adjustments.
- Much of the information used to support the accounts is manual in nature, rather than system generated, which increases the overall risk of error.

16. As a result of the range and scale of issues the auditors have assessed that they are unable to provide an audit opinion on Scottish Canals' financial statements. While this relates specifically to the property, plant and equipment balances of £407 million in the financial statements, the financial value and core importance of these assets to Scottish Canals' strategic objectives led the auditors to judge that these issues affected the financial statements as a whole. The issuing of a disclaimer on the audit opinion, means that the auditors cannot provide assurance on the use of public money by Scottish Canals during 2021/22.

17. To date Scottish Canals has spent more than £0.5 million on consultant support for its asset valuation activity which had not originally been budgeted for. There will also be ongoing costs. Scottish Canals has set aside £100,000 for valuation work in 2022/23, with external procurement planned for valuation support for future years. Consultants currently retain ownership of the valuation model which could mean that Scottish Canals will have ongoing spending commitments to support its annual valuations work. Scottish Canals will need to consider the value for money of the approach it takes to progressing this work, including any ongoing use of consultants.

Scottish Canals needs to make sure it can meet its financial accountability responsibilities as a matter of urgency

18. Scottish Canals needs to quickly finalise its approach to recording and valuing its assets to meet its public accountability responsibilities and comply with Financial Reporting Manual requirements. Without this, auditors cannot provide assurance over Scottish Canals' use of public money.

19. As an organisation whose core function involves the management of infrastructure assets, it is important that Scottish Canals has a robust and accurate record of the assets it owns, and that appropriate valuations are obtained for these assets. The auditors have set out specific areas in [Appendix](#)

[two of the 2021/22 annual audit report](#) which require consideration by Scottish Canals. These include ensuring all property, plant and equipment records are included in the fixed asset register; the maintenance of accurate and timely records; appropriate matching of expenditure recorded in the project management system to the fixed asset register; maintaining evidence of ownership and existence of assets; and determining an approach to re-evaluations.

20. A new Chief Executive took up post with Scottish Canals in late May 2023. He will need to work quickly, with the support of Transport Scotland in its role as Scottish Canals' Scottish Government sponsor division, to ensure that the organisation implements an effective plan to address these issues and has the expertise and capacity to deliver the improvements needed. They will need to work together to ensure that the implications of the accounting rules that Scottish Canals must work to are fully understood and reflected in the planned response. Scottish Canals will also need to consider the value for money of its approach to valuing its assets, including any ongoing use of consultants.

21. These issues will be a central focus for auditors during the 2022/23 annual audit process. They will engage closely with Scottish Canals to consider the pace and impact of activity being undertaken to address the issues raised. I will continue to monitor progress on these matters and report further in public as necessary.

The 2021/22 audit of Scottish Canals

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