



Scottish Canals

2015/16 Annual audit
report to Members and
the Auditor General

June 2016

Key contacts

Brian Howarth, Assistant Director
bhowarth@audit-scotland.gov.uk

Anne McGregor, Manager
amcgregor@audit-scotland.gov.uk

Gillian McCreadie, Senior Auditor
gimccreadie@audit-scotland.gov.uk

Audit Scotland
4th Floor (South Suite)
8 Nelson Mandela Place
Glasgow
G2 1BT
Telephone: 0131 625 1500
Website: www.audit-scotland.gov.uk

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Brian Howarth, Assistant Director, Audit Scotland is the appointed external auditor of **Scottish Canals** for the period 2011/12 to 2015/16.

This report has been prepared for the use of **Scottish Canals** and no responsibility to any member or officer in their individual capacity or any third party is accepted.

The information in it may be used by the Auditor General in support of her wider responsibilities, including reporting to the Scottish Parliament.

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Key messages

Audit of financial statements

- Unqualified independent auditor's report on the 2015/16 financial statements
- The surplus changed from £1.142m to £641k (a reduction of £477k as a result of audit adjustments)

Financial Position

- operates within available funding (achieving a surplus for the year)
- going concern assumption remains appropriate
- Subject to the realisation of income growth in retail sales and rents and the management of any potential impact from pensions changes, the short term financial position appears robust
- There are issues over the long term sustainability of assets and these are being further evaluated and expressed in longer term financial plans

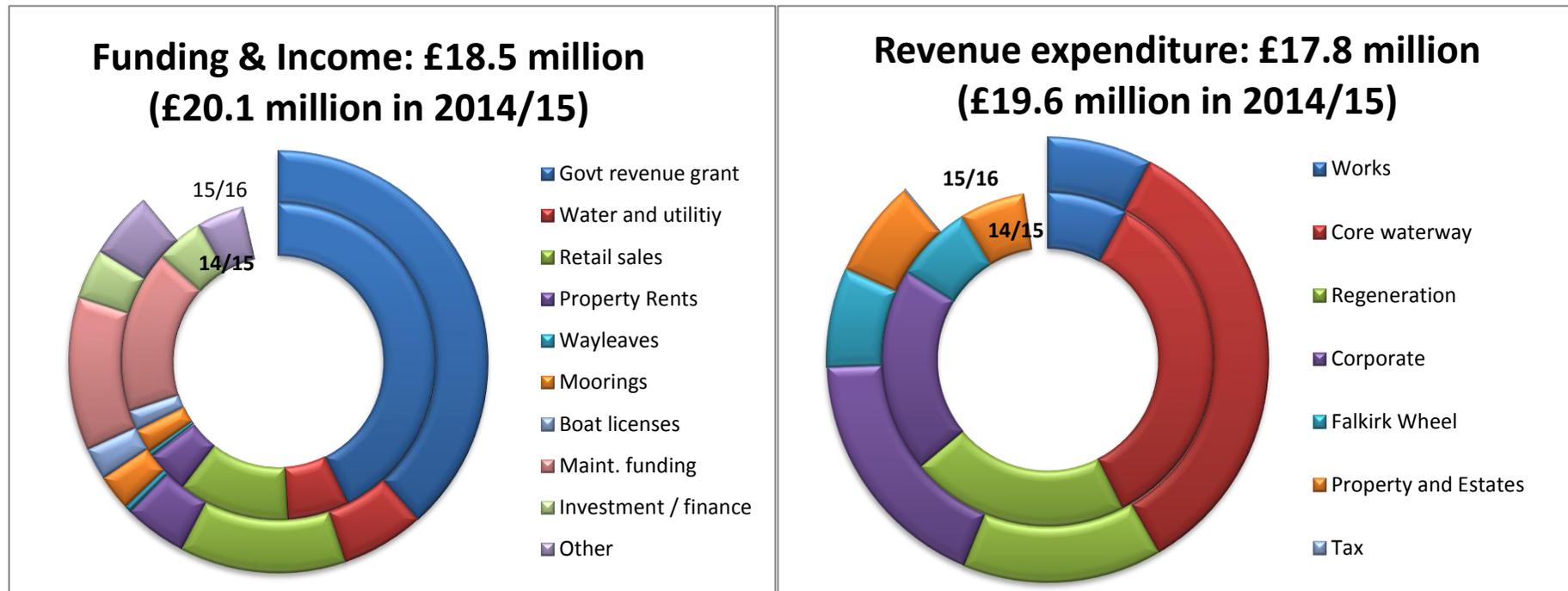
Governance & transparency

- Effective governance arrangements exist
- Some aspects of transparency are limited due to commercial sensitivity/ ministerial approval

Introduction

1. This report is a summary of our findings arising from the 2015/16 audit of Scottish Canals.
2. The management of Canals is responsible for:
 - preparing financial statements which give a true and fair view, in accordance with the relevant financial reporting framework
 - ensuring the regularity of transactions, by putting in place systems of internal control
 - maintaining proper accounting records
 - publishing with their financial statements an annual governance statement and a remuneration report.
3. Our responsibility, as the external auditor, is to undertake our audit in accordance with International Standards on Auditing, the principles contained in the Code of Audit Practice issued by Audit Scotland in May 2011 and the ethical standards issued by the Auditing Practices Board.
4. An audit of financial statements is not designed to identify all matters that may be relevant to those charged with governance. It is the auditor's responsibility to form and express an opinion on the financial statements prepared by management with the oversight of those charged with governance. This does not relieve management of their responsibility for the preparation of financial statements.
5. A number of reports, both local and national, have been issued by Audit Scotland during the course of the year. These reports are summarised at [appendix II](#).
6. [Appendix III](#) is an action plan setting out our recommendations to address the high level risks we have identified from the audit. Officers have considered the issues and agreed to take the specific steps in the column headed "Management action/response". We recognise that not all risks can be eliminated or even minimised. What is important is that Scottish Canals understands its risks and has arrangements in place to manage them. The Audit and Risk committee should ensure that they are satisfied with proposed action and have a mechanism in place to assess progress and monitor outcomes.
7. We have included in this report only those matters that have come to our attention as a result of our normal audit procedures; consequently, our comments should not be regarded as a comprehensive record of all deficiencies that may exist or improvements that could be made.
8. The cooperation and assistance afforded to the audit team during the course of the audit is gratefully acknowledged.
9. 2015/16 is the final year of the current five year audit appointment. From 2016/17 the auditor of Scottish Canals will be Grant Thornton. In accordance with agreed protocols and International Standards on Auditing we will be liaising with the incoming auditors as part of this transition.

2015/16 financial statements



The Statement of Comprehensive Income, in the financial statements, shows that total funding and income reduced by £1.1m (6%). Scottish Government revenue funding reduced by 10% from last year, due to a reduction in the Future Transport Fund grant. Third party maintenance and repair funding reduced by 30%. These reductions were partly mitigated by increases across other income categories: in particular retail sales which grew by 12%.

The financial statements also show that annual revenue expenditure has reduced by £1.7m (9%) in 2015/16. The main reduction (£1.4m) is in Regeneration due to the decrease in activities on the towpath network. While work continues on towpath regeneration, it was much higher in 2014/15.

Audit of the 2015/16 financial statements

Audit opinions

Financial Statements	<ul style="list-style-type: none">• The financial statements of Scottish Canals for 2015/16 give a true and fair view of the state of the body's affairs and of its surplus for the year.• We confirm that the financial statements have been properly prepared in accordance with IFRSs; the Transport Act 1962 and directions by Scottish Ministers.
Regularity	<ul style="list-style-type: none">• In all material respects, the expenditure and income in the financial statements were incurred or applied in accordance with any applicable enactments and guidance.
Other prescribed matters	<ul style="list-style-type: none">• The part of the Remuneration Report to be audited has been properly prepared in accordance with the Transport Act 1962 and directions made thereunder by the Scottish Ministers.• The information given in the directors' report and strategic report of the Annual Report is consistent with the financial statements.

Submission of financial statements for audit

10. We received the unaudited financial statements on 2 May 2016, in accordance with the agreed timetable. The working papers were of a good standard and staff provided support to the audit team which enabled us to complete our on-site fieldwork on 20 May 2016.

Overview of the scope of the audit of the financial statements

11. Information on the integrity and objectivity of the appointed auditor and audit staff, and the nature and scope of the audit, were outlined in our Annual Audit Plan presented to the Audit and Risk committee on 3 December 2015.
12. As part of the requirement to provide full and fair disclosure of matters relating to our independence, we can confirm that we have not undertaken any non-audit related services. The 2015/16 agreed fee for the audit was £32,000 and, as we did not carry out any work additional to our planned audit activity, the fee remains unchanged.
13. The concept of audit risk is of central importance to our audit approach. During the planning stage of our audit we identified a number of key audit risks which had the greatest effect on the audit strategy, resources and effort. We set out in our Annual Audit Plan the audit work we proposed to undertake to secure appropriate levels of assurance.

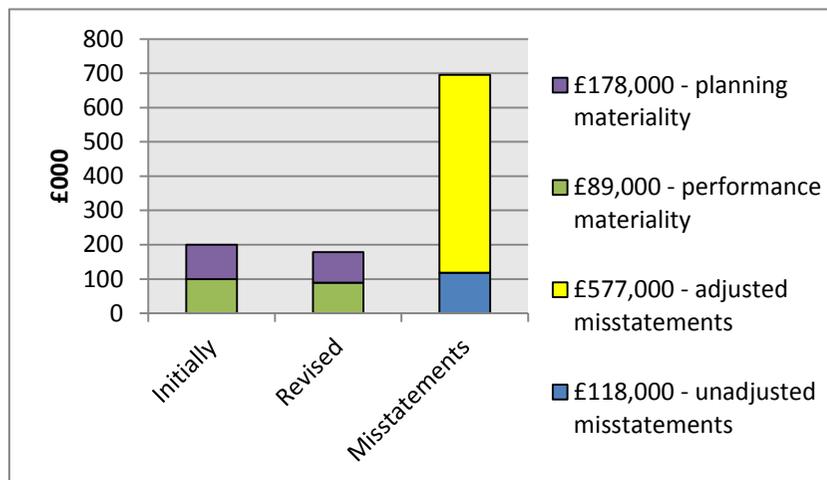
14. [Appendix I](#) sets out the audit risks identified at the planning stage and how we addressed each risk in arriving at our opinion on the financial statements.
15. Our audit involved obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error.

Materiality

16. We consider materiality and its relationship with audit risk when planning the nature, timing and extent of our audit and conducting our audit procedures. We assess the materiality of uncorrected misstatements, both individually and collectively.
17. We consider materiality and its relationship with audit risk when planning the nature, timing and extent of our audit and conducting our audit programme.
18. We summarised our approach to materiality in our Annual Audit Plan. We revised our planning materiality for 2015/16 on receipt of the unaudited accounts to £178,000 (1% of operating expenditure of £17.8 million).
19. We also set a lower level, known as performance materiality, when defining our audit procedures. This is determined to ensure that uncorrected and undetected audit differences do not exceed our materiality level. Performance materiality was set at £89,000 (i.e. 50% of materiality).

20. We report all misstatements greater than £5,000.

Exhibit 1: Overall materiality misstatements



Evaluation of misstatements

21. We identified four misstatements in the unaudited financial statements. Misstatements for pensions (Para. 26) and missed accrual (£17k) have been adjusted by management in the audited accounts with the unaudited surplus of £1,142k reducing to £641k. Some of the reduction (£24k) is for the tax liability which was provided during the audit. The investment revaluation reserve (Para. 29) misstatement (£100k) is an adjustment within the reserves and has no impact on the surplus. The remaining misstatement is unadjusted and totals £118k (Para. 28). This has no impact on the surplus as it is a classification issue within the balance sheet.

22. The total value of adjustments exceeded our overall performance materiality level of £89k.

- We reviewed all pension adjustments identified in the actuary’s IAS19 report and this was the only error in the accounting treatment in this area (Para. 26);
- The missed accrual of £17k was identified as the only error in post-year end payments of £1,113k examined (1.5% error rate)
- The issue with the error in treatment of revaluation adjustments is confined within the retained earnings reserves and arose from our review of the only disposal of investment property in 2015/16 (Para. 29);
- The unadjusted error represents the only error in year-end trade payables, where we tested £848k of invoices (69% of the total balance).

23. We determined that these are isolated issues which do not indicate that further systematic errors exist within the account areas or more pervasively within the financial statements. We considered the impact of these misstatements on our audit approach and decided that further audit procedures were not required.

Significant findings from the audit

24. International Standard on Auditing 260 (ISA 260) requires us to communicate to you significant findings from the audit as detailed below:

- The auditor’s views about significant qualitative aspects of the entity’s accounting practices, including accounting policies, accounting estimates and disclosures.
 - Significant difficulties encountered during the audit.
 - Significant matters arising from the audit that were discussed, or subject to correspondence with management.
 - Written representations requested by the auditor.
 - Other matters which in the auditor's professional judgment, are significant to the oversight of the financial reporting process.
25. The following table details those issues or audit judgements that, in our view, require to be communicated to those charged with governance in accordance with ISA 260.

Table 1: Significant findings from the audit

Significant findings from the audit in accordance with ISA260	
	<p>Accounting treatment of pension current service costs</p> <p>26. Accounts presented for audit included £230k for pension service cost as a credit to the Statement of Comprehensive Income when this should have been accounted for as a charge. In Other Comprehensive Income the actuarial gain was accounted for as a loss. The accounts were corrected and the adjustments net off so there was no impact on total comprehensive income for the year. However, the surplus reduced by £460k.</p>
	<p>Accrued income from grant funder</p> <p>27. Testing of accrued income included a balance of £146k for repairs to Bona Lighthouse, which had not changed from 31 March 2015. This looked like a grant due from Historic Scotland but the grant offer letter stated that the grantee is Scottish Waterways Trust. Finance explained that it was Scottish Canals that carried out improvement works on Bona Lighthouse and provided documentation to show the flow of grants. Further confirmation was provided from SWT that the £146k will be paid to Scottish Canals on completion of the lease.</p>

Significant findings from the audit in accordance with ISA260

Asset additions

28. Testing of trade payables included an invoice for £118,400 (incl. VAT £142,080) for purchase of new class hoppers, used for dredging. The asset is included in property, plant and equipment additions for the year. The invoice is dated 30 March the invoice identified that 'these items are being built to order we would require a payment in full before the building process can start'. Scottish Canals could not provide evidence of delivery before 31 March. The accounts were not amended and therefore there is a classification error between property, plant and equipment and current assets (prepayments).

Investment property revaluation reserve

29. The investment property revaluation reserve includes unrealised gains on investment property. An investment property was sold during the year but the revaluation increases attributable to the asset were not transferred out of the reserve. We acknowledge that the information on history of revaluation movements transferred across to Scottish Canals on the split of Canal and River Trust was not available but for this property there was an increase in 2013/14, which should have been reversed. The accounts have been amended and we recommend that Scottish Canals review how they account for future revaluation reserve movements.

Fixed asset register

30. Notes 8 and 9 in the accounts for property, plant and equipment and investment property are based on an asset register. In 2015/16 a number of figures in the asset register required manual adjustments to agree the fixed asset register to the accounts as the distinction between additions and revaluations was not always clear. We were able to agree all the figures but the layout of the register could help provide a clearer link to the accounts and be less time consuming for the finance staff to prepare the asset notes. However, management confirm that the layout is unchangeable but undertook to reduce the number of adjustments next year.

Future accounting and auditing developments

31. The financial statements are prepared in accordance with the Accounts Direction signed by Scottish Ministers and where applicable comply with International Financial Reporting Standards (IFRS) as adopted by the European Union and the accounting and disclosure requirements of companies' legislation currently in force.
32. Per the accounting policies, the following IFRSs and interpretations as modified by the Accounts Direction were in issue but not yet adopted by Scottish Canals in the 2015/16 financial statements.
33. Scottish Canals anticipates that the adoption of these standards and interpretations in future periods will not have a material impact on the financial statements of the organisation.

Code of Audit Practice

34. A new Code of Audit Practice applies to public sector audits for financial years starting on or after 1 April 2016. It replaces the Code issued in May 2011. It outlines the objectives and principles to be followed by auditors. It is part of the overall framework for the conduct of public audit in Scotland.
35. The new Code increases the transparency of our work by making more audit outputs available on Audit Scotland's website. In addition to publishing all annual audit reports,

annual audit plans and other significant audit outputs will be put on the website for all audited bodies. This is irrespective of whether the body meets in public or makes documents such as audit committee papers routinely available on its own website.

Financial position and sustainability

2015/16 financial position

36. The financial statements show that Scottish Canals:
- has net assets of £52 million.
 - operates within its available funding (achieving a surplus of £641k for the year)
 - Achieved positive net cash flows from operations
 - has an excess of current assets over current liabilities (though this has reduced from last year).
37. There is no known change in government policy affecting the body and the budget for 2016/17 is agreed with Transport Scotland as set out in the Budget Act and spending plans.
38. **Going concern.** We concur with management's view that the going concern assumption remains appropriate.

2016/17 financial outlook

39. Scottish Canals' budget for 2016/17 is £17.8 million. This includes a Scottish Government Departmental Expenditure Revenue Limit (RDEL) for the year of £8 million and a budget for capital expenditure (CDEL) of £2 million. This is similar to 2015/16. The remaining £9.8 million of income comes from Scottish Canals own income generating activities.

Financial Planning

40. In June 2014, Audit Scotland reported on [Scotland's public finances](#) and identified that public bodies "face increasingly difficult choices in reducing spending while maintaining service standards and meeting rising demand". The report identified that financial planning improvements were required by public bodies.



41. In the [local government overview](#) report in March 2016, Audit Scotland set out some key questions, which can apply across the Scottish public sector. These questions provide a framework for our assessment of financial planning in Scottish Canals (see below).
42. **Financial position and sustainability.** Subject to the realisation of income growth assumptions in retail sales and rents and the management of any potential impact from pension changes, the short term financial position appears robust.
43. There are issues over the long term sustainability of assets and these are being further evaluated and expressed in longer term financial plans.

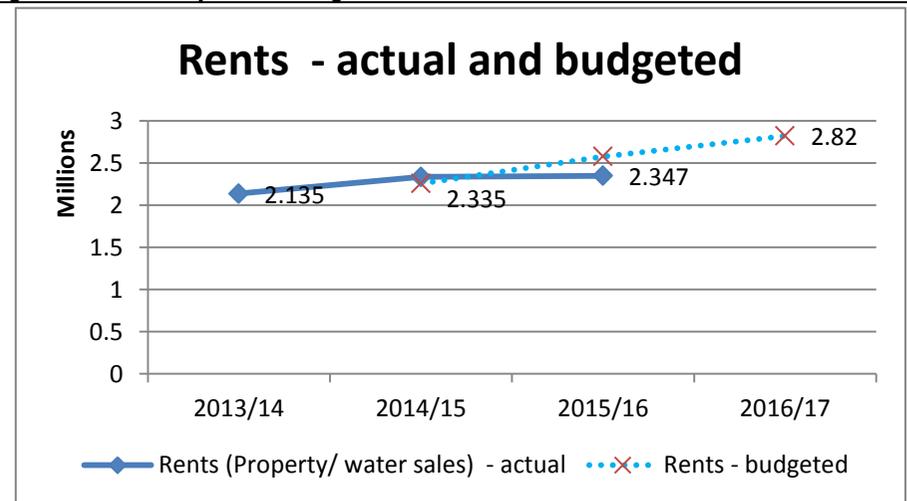
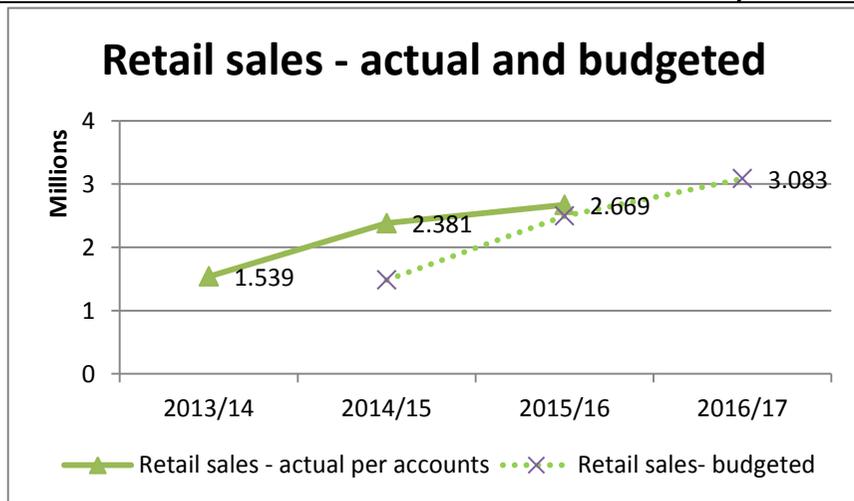
Assessing financial planning

How fully do our financial plans identify estimated differences between income and expenditure (budget shortfall)?

44. Scottish Canal’s Business Plan 2016-17 includes a financial forecast for 2016/17. The plan identifies a small surplus projection of £250k (1.4% of total expenditure) for the year.

What options do we have to address this budget shortfall for example redesign services or use reserves? How big is the remaining funding gap after we implement our selected options? What actions are we taking to close any remaining funding gap?

45. The 2016/17 financial projections contain significant assumptions for income growth - retail sales (growth of around £400k or 16% from 2015/16 outturn) and rents (growth of around £475k or 20%). The financial plan identifies tight control of a number of costs in order to achieve small cost savings in expenditure. Third party income, for towpath and other work, can be volatile, but plans make a prudent assumption of £1.4m and planned activity is dependent on funding received. The business plan notes that there may be “modest” financial impact from any decision to close the existing Waterways Pension Fund from 30 September 2016. Management confirm that income achieved in these two areas is monitored closely and meetings held monthly with budget holders to discuss and address risks.



46. The 2016/17 financial plan demonstrates a balanced budget, but this does not ensure medium/ long term sustainability due to asset maintenance requirements (see below). The remaining funding gap is a recurrent saving or income target of £3m annually. There is, as yet, no medium term financial plan showing whether the funding gap will be narrowed as a result of income growth and cost control efficiencies.

Appendix III – Action Plan No. 1

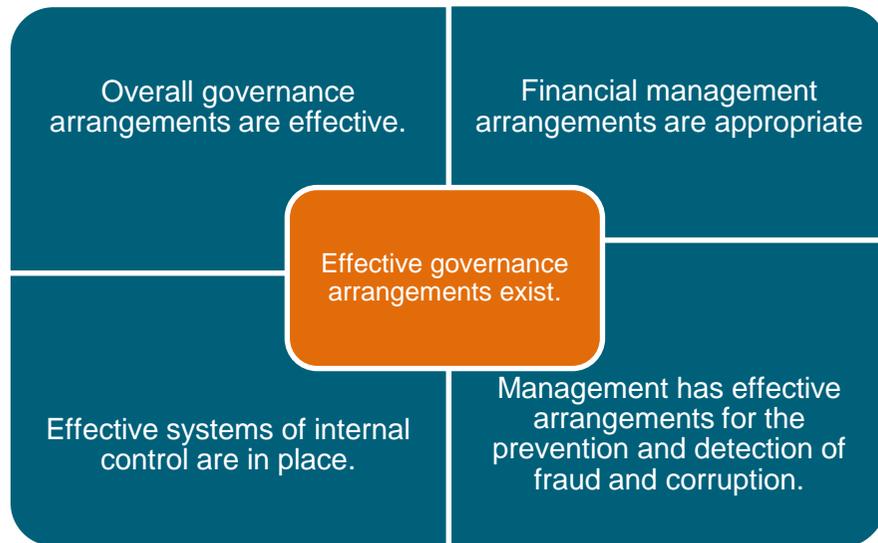
Do we have a long-term financial strategy covering at least five years that accounts for future pressures? Is our five-year strategy supported by detailed financial plans covering a minimum period of three years? How well do our financial plans set out the implications of different levels of income spending and activity? How does our financial strategy link to our vision for the future?

47. The Heritage Strategy (May 2013) set out Scottish Canals’ strategic vision for heritage over 25 years and includes a five-year plan through to 2018. The draft Corporate Plan 2016-19 extends the operational infrastructure asset management strategy and places greater emphasis on long term financial sustainability, The Plan states that many of the underlying infrastructure assets are very old, fragile, and subject to a real and unpredictable risk of asset failure. It recognises that there is a significant on-going maintenance challenge and that long term sustainability will be difficult to achieve. Scottish Canals’ has therefore developed a long term infrastructure asset management strategy/plan. Scottish Canals expects revenue grant-in-aid to remain static in cash terms over the period of the plan and has a ‘relatively cautious’ growth in all other income of 6% (£600,000) per year.

48. Supporting financial plans over a longer period are being established to 2031. The Corporate Plan estimates the full annual cost of managing the canals in a safe, operational, asset condition is £21m (£3m more than the current funding envelope of £19m). Operational and commercial income must increase significantly to achieve long term financial sustainability, by a projected £6m annually by 2031.

Appendix III – Action Plan No. 1

Governance and transparency



Corporate governance

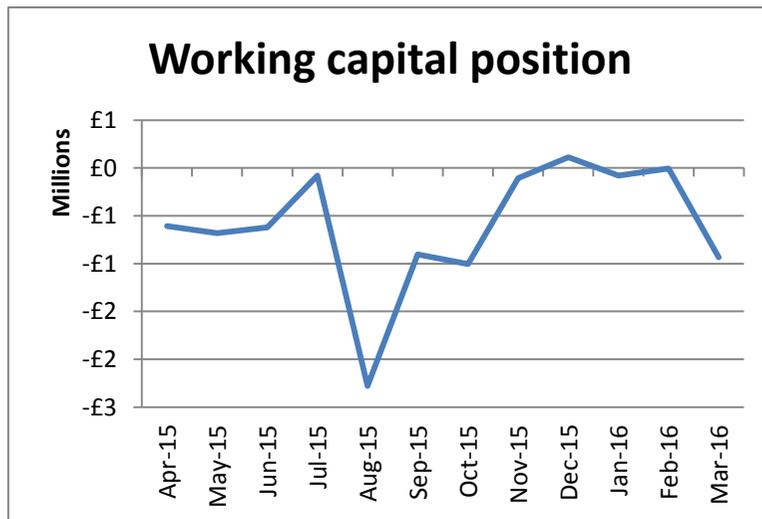
49. The board and Accountable Officer are responsible for establishing arrangements for ensuring the proper conduct of the affairs of Scottish Canals and for monitoring the adequacy of these arrangements. Scottish Canals is managed by a board of non-executives and the Chief Executive.
50. The board is supported in its role by the Audit & Risk Committee. The board meet on a regular basis throughout the year and the

Audit & Risk Committee meets quarterly. We concluded that Scottish Canals has effective overarching and supporting governance arrangements, which provide an appropriate framework for organisational decision making.

Financial management

51. As auditors we need to consider whether bodies have established adequate financial management arrangements. We do this by considering a number of factors, including whether:
 - the director of finance has sufficient status to be able to deliver good financial management
 - standing financial instructions and standing orders are comprehensive, current and promoted within the body
 - reports monitoring performance against budgets are accurate and provided regularly to budget holders
 - monitoring reports do not just contain financial data but are linked to information about performance
 - audit and risk committee members provide a good level of challenge and question significant variances.
52. Within Scottish Canals, the above areas are demonstrated and the financial management has two areas of focus:
 - monitoring incoming and outgoing resources to keep on top of variations from budget; and
 - cash flow control.

53. The basis of cash flow control recognises that the majority of the overall cash is indeed ring fenced for investment purposes. This “commercial capital” includes:
- Dowry monies from CRT (final tranche received in 2015/16 of £1,829k)
 - Receipts from realisation of commercial assets/investments
54. Commercial investments are made from this ring fenced capital and a cash contingency element of £1m is also maintained within the overall balance of £5.3m.
55. The remaining “working capital” cash flows have improved from a relatively poor base following separation from the CRT, through careful management, but short term shortfalls in working capital still occur, with short term impact on the availability of commercial capital.



56. **Financial management arrangements.** Based on our accumulated knowledge, our review of Board meeting papers and through our attendance at the Audit and Risk committee we conclude that Scottish Canals has appropriate financial management arrangements in place.

Transparency

57. The Scottish Government’s On Board guidance (<http://www.gov.scot/Publications/2015/04/9736/0>) for board members of public bodies was updated and reissued in April 2015. On Board states that boards should demonstrate high standards of corporate governance at all times including openness and transparency in decision making. It recommends boards should consider:
- holding an annual open meeting
 - holding board meetings in public unless there is a good reason not to
 - publishing summary reports and/or minutes of meetings
 - inviting evidence from members of the public in relation to matters of public concern
 - consulting stakeholders and users on a wide range of issues
 - making corporate plans and the annual report widely available.
58. Scottish Canals’ website includes a corporate section where you can easily access the annual report and accounts; minutes from Board meetings and details of consultations with the public. The

website includes the Corporate Plan 2014-2017. The revised Corporate Plan 2016-2019 is not currently held on the website as this is still subject to Ministerial approval. This plan is now likely to be amended following the May Scottish Parliament elections. Scottish Canals Board meetings are not held in public and there are no plans to change this due to the commercial sensitivity of the business covered in these meetings.

59. Audit Scotland also expects transparency of financial reporting within the Annual Report and Accounts including:
- A clear reconciliation between expenditure and the outturn against Scottish Government Resource budgets.
 - Identification and explanation of any significant movements in budget during the year.
60. The Scottish Government's budget for 2015/16 was £10m for Scottish Canals. Scottish Canals sponsor (Transport Scotland) provides a split between capital and revenue funding. The strategic report provides the detail of the revenue/capital split and this can be traced through to the accounts (Note 3 Grants receivable from central government, where the accounting of deferred capital element is shown).

Internal control

61. Internal Audit's work programme for the year did not include any reviews of the core financial systems. We carried out a review of controls in place over cash collection at the Falkirk Wheel retail site. From our testing we were able to see takings being reconciled to till

receipts and from this, banking and ledger details being prepared at the Falkirk Wheel; a separate person at Canals House reconciles the ledger to the bank statements. There is only one cashier based out at the Falkirk Wheel but management consider they have sufficient cover arrangements for absences and holiday, and work flexibly to best meet the needs of the finance team and the wider Falkirk Wheel demands.

62. In order for the Accountable Officer to obtain assurance for the corporate governance statement, each of the executive directors completes certificates of assurance. Each Director confirms they have reviewed the required assurances from senior managers and that they are satisfied with the controls in their area of responsibility.

Internal audit

63. Internal audit provides the audit committee and Accountable Officer with independent assurance on the overall risk management, internal control and corporate governance processes. We are required by international auditing standards to make an assessment of internal audit to determine the extent to which we can place reliance on its work. To avoid duplication, we place reliance on internal audit work where possible.
64. As part of our risk assessment and planning process we assessed the Scottish Canals Internal Auditors, BDO LLP, and concluded that they operate in accordance with the Public Sector Internal Audit Standards (PSIAS). This enabled us to place reliance on the work of internal audit, in terms of our wider code responsibilities.

65. The internal audit work planned for 2015/16 is now complete. Five reviews were completed with two substantial and three moderate assurance ratings given. There were no high risk recommendations. The report on Business Continuity and emergency planning included recommendations to improve the plans on roles and responsibilities, realistic timescales, impact of downtime and testing to be completed.
66. Overall internal audit concluded that based on their verification reviews and sample testing, risk management, control and governance arrangements were operating with sufficient effectiveness to provide reasonable, but not absolute assurance that the related risk management, control and governance objectives were achieved for the period under review.
67. Scottish Canals are tendering for internal audit services as the current contract finishes in June 2016.

Arrangements for the prevention and detection of fraud

68. Scottish Canals is responsible for establishing arrangements to prevent and detect fraud and other irregularity. We assessed the arrangements for the prevention and detection of fraud during the planning phase of our audit. This involved reviewing the anti-fraud and anti-bribery standards, approved annually by the Board, and the Whistleblowing policy in place. Both documents are communicated to staff and are appropriate to the organisation.

Arrangements for maintaining standards of conduct and the prevention and detection of corruption

69. Audited bodies are responsible for ensuring that their affairs are managed in accordance with proper standards of conduct and have proper arrangements in place for implementing and monitoring compliance with standards and codes of conduct, standing orders and financial instructions. We consider whether bodies have adequate arrangements in place and have concluded that appropriate arrangements exist within Scottish Canals.

Performance reporting

70. Accountable officers have a specific responsibility to ensure that arrangements have been made to secure Best Value. A key component of this is performance reporting and management.
71. Scottish Canals Corporate Plan 2016-19 outlines its three strategic themes: growing public value; increasing financial sustainability and empowering and motivating people. It states from the outset how these are linked to the National Outcomes of the Scottish Government's National Performance Framework and how it reflects the priorities set out in the Economic Strategy.
72. Each of Scottish Canals strategic themes are linked to the most appropriate National Outcome. From this, each theme then has its own suite of outcomes based on Key Performance Indicators (KPIs).

73. The KPIs are reported to the Board throughout the year within the quarterly business report. There is narrative on each KPI and each is categorised as red, amber or green in terms of progress at the different stages of the year. The monitoring of these measures help to drive continuous improvement and Best Value. Also, Scottish Canals use KPI results to monitor their overall contribution to the National Outcomes. The Strategic Report, within the Annual Report & Accounts, identifies 42 measures were reported on in 2015/16. Of these, only two were considered as not achieved or in the process of being achieved.

National performance audit reports

Scotland's Public Sector Workforce

74. Audit Scotland published *Scotland's Public Sector Workforce* in November 2013 and in 2015/16 a follow-up is being carried out across all audited bodies as part of national follow-up report.
75. At Scottish Canals, Empowering and Motivating people is a core theme in the corporate plan. There is a two year workforce planning programme (2015-2016) in place under this theme and updates included in the quarterly business reports. The programme is wide-ranging covering for example: job evaluations, terms and conditions harmonisation and leadership development. Trade unions are involved in the programme. Alongside this an organisational development strategy is being prepared.
76. This year, 2016, is the second year of the programme and due to personnel changes there has been some slippage in timescales in

the programme, but overall executive team are working to completion of main projects by December 2016.

77. Volunteering and partnership working both play significant role in developing the canals. The charity, Scottish Waterways Trust is a key partner in getting the public to use the canals ranging from recreational visits to more focused programmes reaching disadvantaged communities along the canals.

Community planning: an update

78. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. From those reports published in the last year, one was [Community Planning: an Update](#).
79. Under Scottish Canal's Empowering and Motivating people theme, the Corporate Plan states that Scottish Canals supports the Scottish Government's emphasis on involving local people in the design and delivery of public services. It also outlines that Scottish Canals already has working relationships with other parts of the public and third sectors, private sector and also at a local community and individual level. This report is therefore of relevance to the work carried out by Scottish Canals. The key messages from this report are detailed below.
80. Since the publication of the Scottish Government and COSLA's joint Statement of Ambition in 2012, they have continued to promote community planning as central to effective public service reform.

Governance and transparency

81. Progress on community planning is being made both locally and nationally. But it is not yet delivering the ambitious changes in the way public services are organised and delivered, with and for communities that were envisaged in the Statement of Ambition.
82. The way in which public bodies report performance, and are held to account, does not always reflect the Scottish Government's policy of promoting outcomes, prevention and reducing inequalities.
83. Stronger national leadership is needed to enable community planning to meet its full potential.
84. There is a need to streamline national performance management frameworks and create a better balance between measures of service performance and local outcomes, prevention and the performance of partnerships.

Appendix I: Significant audit risks

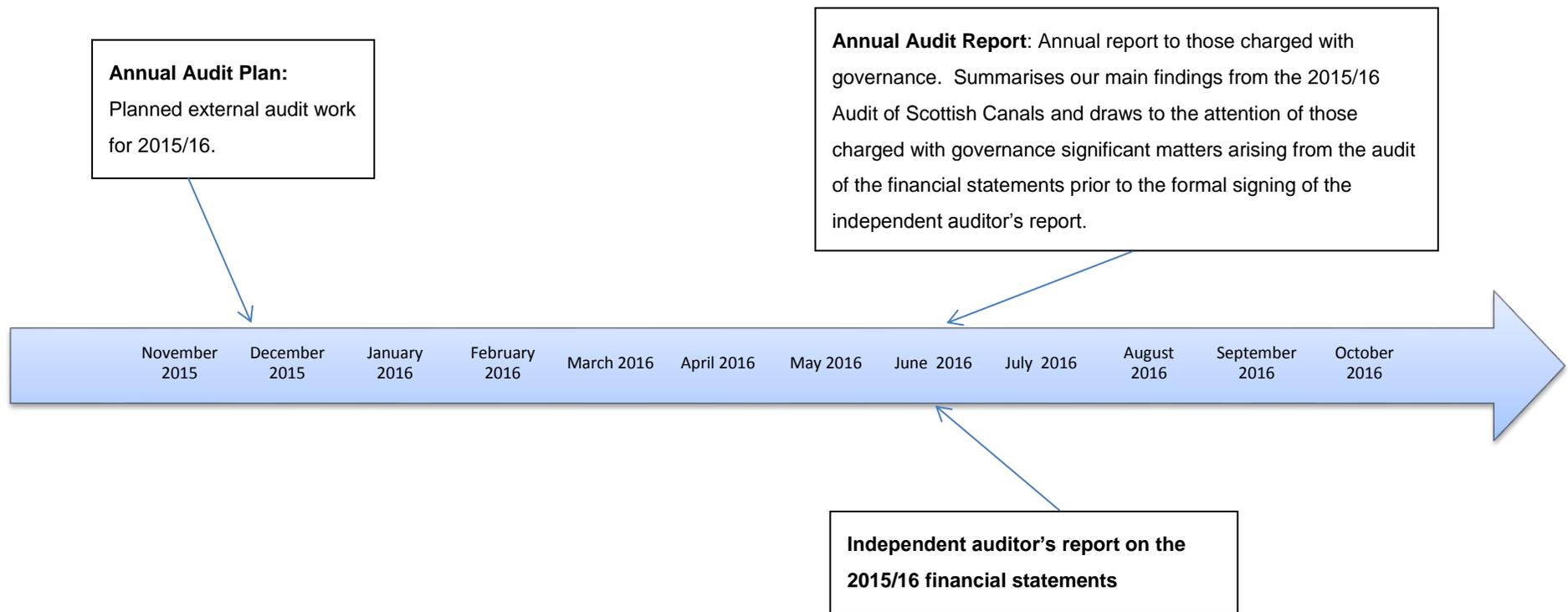
The table below sets out the audit risks we identified during the course of the audit and how we addressed each risk in arriving at our opinion on the financial statements.

Audit Risk	Assurance procedure	Results and conclusions
Risk of material misstatement		
<p>Risk of fraud in revenue recognition</p> <p>ISA240 presumes a risk of fraud where income streams are significant.</p> <p>The extent of income at Scottish Canals means that there is an inherent risk income could be materially misstated.</p>	<p>Analytical review of income streams to confirm completeness and identify any unusual transactions or variations in income.</p> <p>Substantive testing of income transactions to confirm occurrence and accuracy.</p> <p>Review of controls in place over cash collection at the Falkirk Wheel.</p>	<p>Analytical review and detailed substantive testing of income transactions were undertaken and results satisfactory.</p> <p>We confirmed that reconciliations are carried out at the Falkirk Wheel from till receipts to takings and then at Canals House from the ledger to bank statements.</p> <p>No fraudulent activity was identified.</p>
<p>Valuations</p> <p>The financial statements of Scottish Canals include a range of assets and liabilities that rely on the provision of valuations by management experts.</p> <p>There is a risk of error in valuation assumptions used by actuary and valuer.</p>	<p>Consideration of the nature, scope and assumptions made in these valuations.</p>	<p>We reviewed the nature, scope and assumptions in the valuations by the actuary (who had changed from 2014/15) and the valuer. We did not identify any material error in the valuations.</p>

Audit Risk	Assurance procedure	Results and conclusions
<p>General moorings valuation</p> <p>The general moorings' valuation is based on applying a multiplier to the annual moorings income figure. There is a risk of material misstatement linked to the valuation as it is susceptible to year-on-year fluctuation dependant on the income figure used.</p>	<p>Substantive testing of moorings income transactions to confirm occurrence and accuracy.</p> <p>Detailed review of the valuation calculation, based on the income figure.</p> <p>Considered IFRS 13 <i>Fair value measurement</i> disclosure requirements</p>	<p>Substantive testing of moorings income confirmed the accuracy and occurrence of transactions.</p> <p>We reviewed the calculations to determine the valuation. There were two changes that impacted the moorings: the price is now based on full length of the mooring when it used to be based per unit and secondly, the valuer changed the multiplier from 6 to 5.8 after considering sustainability of the growth and longer term plans from changes in charging policy. Had the multiplier remained at 6 the valuation would have been £114,000 higher.</p> <p>Overall, we concluded that the calculation was appropriate but additional disclosures were included to meet IFRS13 requirements.</p>
<p>Management override of controls</p> <p>ISA240 requires that the audit work is planned to consider the risk of fraud, which is presumed to be a significant risk in any audit. This includes considering the risk of management over-riding controls in order to change the position disclosed in the financial statements.</p>	<p>Detailed testing of journal entries.</p> <p>Review of accounting estimates for bias.</p> <p>Evaluation of significant transactions that are outside the normal course of business.</p> <p>Focused testing of accruals and prepayments.</p>	<p>The audit procedures did not identify any instances of management override of controls.</p> <p>Accounts were adjusted for a missed accrual for £17k.</p> <p>All termination payments were approved by the Scottish Government per the Scottish Public Finance Manual requirements.</p>

Audit Risk	Assurance procedure	Results and conclusions
Risks identified from the auditor's wider responsibility under the Code of Audit Practice		
<p>2015/16 financial outturn</p> <p>Scottish Canals has budgeted to deliver a surplus of £0.075 million for 2015/16, based on retail income increasing from £1.8 million in 2014/15 to £2.5 million; of which £2 million would come from the Falkirk Wheel. This is a significant increase in retail income and there is a risk the retail income will not be achieved.</p>	<p>Review of the accuracy of budgets based on actual results through the year.</p> <p>Review of the results of the internal audit report on budget setting/ income.</p> <p>Assessment of the year end position based on the surpluses achieved, the balance sheet position and income targets.</p>	<p>Retail sales increased to £2.7 million. Operating surplus before IAS 19 adjustments was £0.1 million.</p> <p>The retail income budget was £2.494m, with reforecast as at September at £2.434m and actual outturn £2.669m</p> <p>Internal audit gave 'substantial assurance' on the design and operational effectiveness on budget setting of income.</p> <p>Overall concluded that Scottish Canals has strong financial management arrangements in place but medium financial and long-term planning is not fully developed.</p>

Appendix II: Summary of local audit reports 2015/16



Appendix III: Action plan

No. AS ref.	Paragraph ref.	Issue/risk/Recommendation	Management action/response	Responsible officer / Target date
1. Internal ref 68556	46 and 48	<p>Medium financial and long term planning is being developed. Scottish Canals recognise there are medium/ long term issues with asset sustainability and are beginning to enumerate this.</p> <p>A stable short term operational budget is maintained but there is a risk that long term operation is dependent on reactive and substantial investment when failures arise in operational assets.</p> <p>We recommend that the long term financial strategy is agreed and published. This should set out scenario plans (best, worst, most likely); the contribution of any measures to close funding gaps; the residual funding gap and any residual risks.</p>	<p>There is ongoing consideration by the Board of the asset management plan and associated risk register, with mitigating actions being pursued in the absence of recognised maintenance funding.</p> <p>Longer terms plans are being developed but will be shaped by the outcome of the comprehensive spending review and decisions taken by not just our Board but Ministers and will not be developed more fully until after the comprehensive spending review and budgets are determined.</p>	<p>Director of Finance</p> <p>31 March 2017</p>