

# Public Audit Committee

## 6th Meeting, 2022 (Session 6), Thursday, 24 February 2022

### The 2020/21 audit of Scottish Canals

#### Introduction

1. The Public Audit Committee will take evidence today from the Auditor General for Scotland (AGS) on his report on [The 2020/21 audit of Scottish Canals](#), which was published on 8 February 2022.
2. The AGS has prepared a note on the key messages from the report, which, along with a copy of the briefing, can be found in the Annexe.

**Clerks to the Committee**  
**21 February 2022**

**Annexe**

### **BRIEFING PAPER BY THE AUDITOR GENERAL FOR SCOTLAND**

1. The Auditor General published a report under section 22 of Public Finance and Accountability (Scotland) Act 2000 on the 2020/21 audit of Scottish Canals on 8 February 2022.
2. The auditor issued a disclaimer of opinion on Scottish Canals' annual report and accounts for 2020/21. The auditor was unable to obtain sufficient audit evidence to conclude on the overall valuation of Scottish Canal's canal infrastructure and inland waterways and the appropriateness of the historically accepted treatment of capitalising additions since responsibility for the waterways was devolved to Scotland in 2012.
3. The Auditor General has prepared this report to draw the Scottish Parliament's attention to the unusual nature of the disclaimer and the importance of having

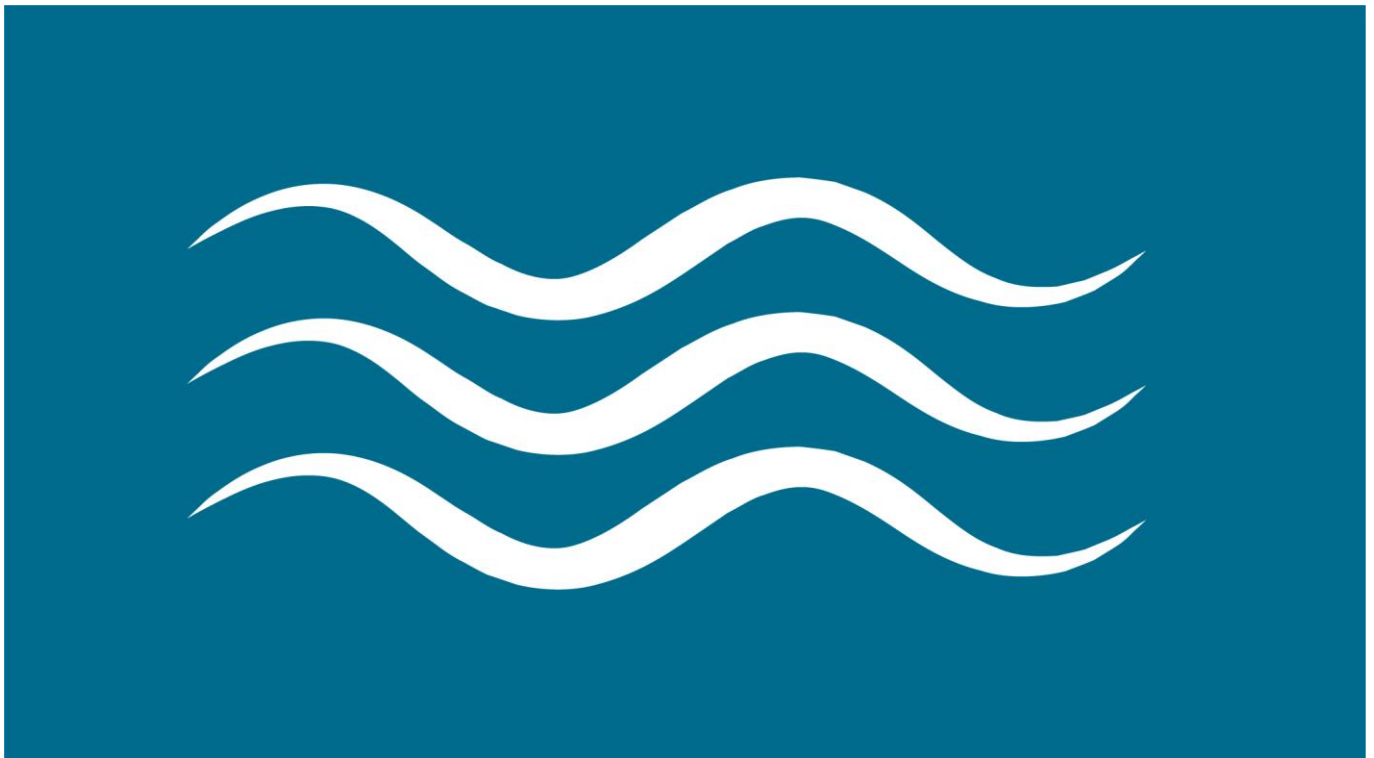
appropriate valuations for these specialist operational assets to support Scottish Canals' medium-term financial strategy and asset management strategy.

4. Key messages from the report are:

- Scottish Canals was required to follow HM Treasury's Financial Reporting Manual (FReM) when preparing its financial statements for 2020/21 following a change in its status from a public corporation to a non-departmental public body. Although the required valuations for investment properties and land and buildings were conducted, the auditor identified during the course of their initial work that Scottish Canals had not obtained a valuation for around £51 million of specialist operational assets which had been capitalised between 2012 and 2021. The FReM required these assets to be valued using depreciated replacement cost.
- Scottish Canals subsequently appointed external support to undertake the valuation of these assets but the auditor noted a number of concerns with the resultant valuations. These included doubts about the qualifications of the valuer being wholly relevant to undertake the valuation of all the specialist operational assets; and concerns that the Fixed Asset Register, on which the valuation was based, lacked sufficient detail and may contain duplicate assets. The auditor also raised questions over the capitalisation of some expenditure. As a result, the auditor was unable to gain sufficient audit evidence to support the current value in existing use of £51 million of specialist operational assets. The auditor issued a disclaimer on the audit opinion because the accounts could contain material misstatements.

5. Scottish Canals will now undertake a new valuation process of the canal infrastructure estate in its entirety during 2022. A key part of this work will require Scottish Canals to review its Fixed Asset Register to ensure that all assets are appropriately recorded and categorised. This will be a substantial piece of work but it is 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. It is vitally important that Scottish Canals' Board is able to reassure itself that the organisation has sufficient skills and capacity to deliver this project, and that it provides appropriate support and challenge to ensure it is delivered to plan.

# The 2020/21 audit of Scottish Canals



AUDITOR GENERAL 

Prepared by the Auditor General for Scotland  
Made under section 22 of the Public Finance and Accountability (Scotland) Act 2000  
February 2022

---

# The 2020/21 audit of Scottish Canals

---

## Introduction

**1.** I have received the audited annual report and accounts and the independent auditor's report for Scottish Canals for 2020/21. I am submitting these financial statements and the auditor's 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.** The auditor issued a disclaimer on the audit opinion on Scottish Canals' financial statements for 2020/21. The auditor considered that insufficient audit evidence was available to conclude on the overall valuation of Scottish Canal's canal infrastructure and inland waterways and the appropriateness of the historically accepted treatment of capitalising additions since responsibility for the waterways was devolved to Scotland in 2012. I have prepared this report to draw to the Scottish Parliament's attention the unusual nature of the disclaimer and the importance of having appropriate valuations for these specialist operational assets to support Scottish Canals' medium-term financial strategy and asset management strategy.

## Key messages

**3.** Scottish Canals was required to follow HM Treasury's Financial Reporting Manual (FRM) when preparing its financial statements for 2020/21 following a change in its status from a public corporation to a non-departmental public body (NDPB). Although the required valuations for investment properties and land and buildings were conducted, the auditor identified during the course of their initial work that Scottish Canals had not obtained a valuation for around £51 million of specialist operational assets which had been capitalised between 2012 and 2021. The FRM required these assets to be valued using depreciated replacement cost.

**4.** Scottish Canals subsequently appointed independent external support to undertake the valuation of these assets. However, the auditor noted a number of concerns with the resultant valuations, including doubts about the qualifications of the valuer being wholly relevant to undertake the valuation of all the specialist operational assets and concerns that the Fixed Asset Register, on which the valuation was based, lacked sufficient detail and may contain duplicate assets. The auditor also revisited the capitalisation of these assets and raised questions over the capitalisation of some of that expenditure. As a result, the auditor was unable to gain sufficient audit evidence to support the current value in existing use of £51 million of specialist operational assets. The

auditor issued a disclaimer on the audit opinion because the accounts could contain material misstatements.

**5.** Scottish Canals will now undertake a new valuation process of the canal infrastructure estate in its entirety during 2022. A key part of this work will require Scottish Canals to review its Fixed Asset Register to ensure that all assets are appropriately recorded and categorised. This will be a substantial piece of work but it is 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. It is vitally important that Scottish Canals' Board is able to reassure itself that the organisation has sufficient skills and capacity to deliver this project, and that it provides appropriate support and challenge to ensure it is delivered to plan.

## Background

**6.** Scottish Canals is the operating name for the British Waterways Board, originally established under the Transport Act 1962 to manage and maintain inland waterways across Great Britain. Under the Scotland Act 1998, responsibility for inland waterways in Scotland was devolved to the Scottish Parliament and the British Waterways Board was designated as a cross-border public authority. Scottish Canals was created as a public corporation in July 2012, after the UK Government decided that the British Waterways Board's functions and assets in England and Wales would transfer to a new charity, Canal & River Trust.

**7.** 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.<sup>1</sup> Historically considered as a key part of Scotland's transport network, canals have over time transformed into what is now a more diversified asset which contributes to Scotland's tourism and regeneration economy. 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.

**8.** Scottish Canals consists of a board comprising a chair, a vice chair and between one and four members appointed by Scottish ministers.<sup>2</sup> As such, it operates on a day-to-day basis independently from the Scottish Government, but for which Scottish ministers are ultimately accountable to the Scottish Parliament. Scottish Canals' chief executive, as accountable officer for the organisation, is also personally accountable to the Scottish Parliament for ensuring its resources are used economically, efficiently and effectively.

**9.** Scottish Canals' Corporate Plan 2020-23, and its supporting 10-year asset management strategy, sets out priorities which include maintaining and

<sup>1</sup> Scotland's five canals are: the Forth & Clyde, Union and Monkland Canals in the Lowlands; the Crinan Canal in Argyll; and the Caledonian Canal in the Highlands.

<sup>2</sup> The Board currently consists of the chair, five non-executive members and the chief executive.

restoring the canal network, making a greater contribution to the Scottish economy and tackling climate change. But at the moment, the cost of running Scottish Canals, alongside the required investment in the network, exceed the funding and income available. Scottish Canals' medium-term financial strategy 2021-26, which it is currently preparing, is expected to set out how it will achieve efficiencies in its cost base and generate additional income, while also delivering its capital investment programme. A key part of the investment programme is how best to address Scottish Canals' maintenance backlog which is currently assessed at around £70 million.

## Scottish Canals' financial performance 2020/21

**10.** Scottish Canals' reporting status changed from April 2020 as a result of a review by the Office for National Statistics.<sup>3</sup> Now reporting as an NDPB, Scottish Canals was required for the first time in 2020/21 to account for its activities in accordance with HM Treasury's Government Financial Reporting Manual (FRoM). Key features of this include:

- The preparation of a Statement of Comprehensive Net Expenditure (SoCNE) showing Scottish Canals' income and revenue expenditure for the year.
- Grant in Aid received from Transport Scotland, as Scottish Canals' sponsor division, is regarded as a source of funding rather than income. In effect, Grant in Aid is used to offset any deficit on the SoCNE and to support Scottish Canals' capital investment programme.
- Other grants received are recognised as income through the SoCNE. This includes monies received from partners in joint-development projects, such as Glasgow City Council as part of the Smart Canal project.
- Expenditure classified as capital expenditure creates a non-current asset and/or enhances an existing non-current asset. All property, plant and equipment assets so created are required to be valued using depreciated replacement cost (DRC), ie the cost of replacing these assets in their current condition and existing use. Previously, these assets were held at historic cost and subject to an annual depreciation charge.

**11.** Scottish Canals' financial statements show that in 2020/21 it generated income of £18.8 million and incurred revenue expenditure of £22.7 million, resulting in net operating expenditure of £3.9 million. Capital grants of £12.6 million were the biggest source of income (67 per cent), followed by water and utility sales of £1.4 million. Scottish Canals employed an average of 216 whole

<sup>3</sup> The Office for National Statistics (ONS) determine a bodies' national accounting classification based on whether an organisation is public or private and market or non-market in order to produce accurate national accounts. The ONS decided that because Scottish Canals carried out administrative, commercial, executive or regulatory functions on behalf of government it had more of the characteristics of an NDPB.

time equivalent staff in 2020/21. Staff costs, at £9.7 million, were the highest source of operating expenditure (43 per cent).

**12.** Transport Scotland provided Revenue Grant in Aid of £9.6 million and Capital Grant in Aid of £20.2 million during 2020/21. Revenue Grant in Aid received was £1.1 million more than in 2019/20, partly as a consequence of a reduction in commercial income of £3.2 million associated with Covid-19 restrictions.

**13.** Capital Grant in Aid also increased from the £6.5 million received in 2019/20. In addition to the £12.2 million provided as part of Scottish Canals' planned investment programme for the year, Transport Scotland provided £6.5 million to restore the navigation and undertake priority improvement works as a result of the Muiravonside breach in the Union Canal in August 2020.

### Disclaimer on the audit opinion

**14.** On the creation of Scottish Canals in 2012 the canal network in Scotland was transferred to its ownership as a heritage asset, with no value attributed to it in the financial statements. Because of this, the canal network has never been valued in its entirety or disclosed in Scottish Canals' financial statements since then. The £133.9 million of non-current assets shown in the SoFP as at 31 March 2021 represents capital spend since 2012 which has resulted in the creation of new assets, or has enhanced the economic benefit associated with existing assets. This largely comprises £105.1 million in property, plant and equipment, and £24.2 million in investment property.

**15.** As noted in [paragraph 10](#) above, Scottish Canals previously valued property, plant and equipment at historic cost, subject to an annual depreciation charge. Investment property was valued annually at fair-value. Under the FReM, property, plant and equipment deemed to be held for their service potential, including those termed as specialist operational assets, are required to be valued at current value in existing use. In practice, this means valuing these assets using depreciated replacement cost (DRC). Investment property continues to be valued using fair-value.

**16.** As part of its transition to the FReM Scottish Canals commissioned the same firm of property consultants who undertake its investment property valuation to also value its land and buildings. However, the RICS qualified valuers were unable to provide a valuation for around £51 million of assets which were not easily identifiable as land and buildings and were considered to be specialist operational assets. Examples of these assets include the Helix park and landscape at the Kelpies, dredging equipment, lock gates and works associated with the widening of the Pinkston canal basin.

**17.** Following discussion with the auditor, in September 2021 Scottish Canals commissioned independent expert engineering support to undertake a valuation of a sample of these assets, representing around 95 per cent of the total population by value. The valuation was intended to determine a DRC valuation, using indices the valuer determined were appropriate. However, the auditor identified a number of concerns with this work:

- The valuer may not have been sufficiently qualified to value all the components of all the specialist assets. The valuer is a specialist engineer and is not RICS qualified. While, because of the nature of the specialist canal assets, it is not necessary to be RICS qualified to value them, the auditor considered that not all the assets valued were specialist engineering ones.
- Scottish Canals' Fixed Asset Register (FAR), upon which the valuation was based, did not clarify sufficiently the historic type of asset. The FAR has also not previously recorded the canal infrastructure and associated additions in separately identifiable components. The auditor noted examples of assets, potentially comprising several different components, being valued as a single asset.<sup>4</sup> Based on their description, the auditor considered that not all the components were necessarily of the same type and questioned whether the single index used to produce the DRC valuation for the asset was appropriate.
- A review by Scottish Canals during the course of the audit identified around £0.5 million of assets recorded in the FAR which were not assets, or the description did not clearly identify the asset enough for the auditor to conclude whether there were any duplicate entries. While Scottish Canals provided photographic evidence of the existence of some of these assets, this did not demonstrate ownership. Overall, the auditor was unable to conclude whether other assets remain in the FAR in error, and whether this would be material.

**18.** In addition to these concerns, the auditor raised questions with Scottish Canals' management judgements over the appropriateness of capitalising certain expenditure during the year. The auditor pointed to examples of capital additions, for example repair of existing towpaths, where it was difficult to identify the underlying asset created through capital spend. The auditor also took account of grant letters, which specifically referred to maintenance as being the purpose of the grant, in concluding that some of this expenditure might have been better regarded as revenue in nature. The auditor was unable to quantify the value of affected expenditure but concluded it was likely to be material.

**19.** Overall, the auditor was unable to gain sufficient audit evidence to support the current value in existing use of £51 million of specialist operational assets. As a result, these assets remain recorded in Scottish Canals' 2020/21 financial statements on an historical cost basis. Specifically, the auditor's opinion states that they were unable to conclude on:

- The appropriateness of the capitalisation of the expenditure as specialist operational assets. The auditor could not determine whether any of this capitalised expenditure was incurred by Scottish Canals in maintaining the canal network and should therefore have been treated as revenue expenditure.

<sup>4</sup> An example of this is the Helix Canal hub in Falkirk, consisting of an access road, improvements to the slipway and moorings.



- The valuation of the specialist operational assets and the suitability of that valuation to evidence compliance with FReM requirements.

**20.** This impacts on the value of the assets included on the Statement of Financial Position, the amount of the expenditure recorded in the Statement of Comprehensive Net Expenditure, and other related entries in the financial statements. As a result of these matters, the auditor was unable to determine whether any adjustments might have been necessary in respect of the property, plant and equipment balances or associated revenue expenditure, Cash Flow Statement and Statement of Changes in Taxpayers' Equity. The auditor issued a disclaimer on the audit opinion because they concluded that the possible effects on the financial statements of undetected misstatements could be both material and pervasive.

## Conclusions

**21.** The adoption of the FReM has had a significant effect on Scottish Canals' accounting policies, financial statements and balances. Scottish Canals has faced challenges in adopting the FReM which have been exacerbated by turnover in its finance team during the period. It has also involved extra time and effort to audit Scottish Canals' 2020/21 financial statements.

**22.** 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. Scottish Canals will now undertake a new valuation process of the canal infrastructure estate in its entirety during 2022. As an initial step, Scottish Canals needs to review the current Fixed Asset Register pertaining to these assets to ensure they are appropriately recorded and categorised.

**23.** This will be a substantial piece of work but it is necessary to provide sufficient evidence to support future judgements and estimates of any FReM-compliant valuation recorded in the financial statements. In turn, this will provide a strong base for Scottish Canals' medium-term financial strategy, support delivery of its asset management strategy and help ensure investment decision-making is in accordance with the priorities set out in its Corporate Plan. It is vitally important that Scottish Canals' Board is able to reassure itself that the organisation has sufficient skills and capacity to deliver this project and that it provides appropriate support and challenge to ensure it is delivered to plan. I expect the auditor to continue to review how Scottish Canals takes these issues forward as part of their audit responsibilities.

# The 2020/21 audit of Scottish Canals

Audit Scotland's published material is available for download on the website in a number of formats. For information on our accessibility principles, please visit:

[www.audit-scotland.gov.uk/accessibility](http://www.audit-scotland.gov.uk/accessibility)

For the latest news follow us on social media or [subscribe to our email alerts.](#)



Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN  
Phone: 0131 625 1500 Email: [info@audit-scotland.gov.uk](mailto:info@audit-scotland.gov.uk)  
[www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk)