



Highlands and Islands Enterprise

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

August 2016

Key contacts

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

Carole Grant, Senior Audit Manager
cgrant@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

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. We help the Auditor General for Scotland and the Accounts Commission check that organisations spending public money use it properly, efficiently and effectively (www.audit-scotland.gov.uk/about/).

Brian Howarth, Assistant Director, Audit Scotland is the appointed external auditor of Highlands and Islands Enterprise for the period 2011/12 to 2015/16.

This report has been prepared for the use of Highlands and Islands Enterprise 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.

Contents

Key messages.....	3
Introduction.....	4
Audit of the 2015/16 financial statements	5
Financial sustainability	12
Governance and transparency.....	16
Best Value	19
Appendix I: Significant audit risks	22
Appendix II: Summary of local audit reports 2015/16.....	25
Appendix III: Summary of Audit Scotland national reports 2015/16.....	26
Appendix IV: Action plan.....	27

Key messages

Audit of financial statements

- Unqualified independent auditor's report on the 2015/16 financial statements.

Financial Position

- Operated within its grant in aid resource limits for 2015/16 including planned surrender of £0.975 million of funding to the Scottish Government on request.
- Stable short-term financial position.
- Scottish Government review of Highlands and Islands Enterprise's roles and responsibilities is ongoing.

Governance & accountability

- Sound and well established governance arrangements in place.
- Systems of internal control operated effectively during 2015/16.

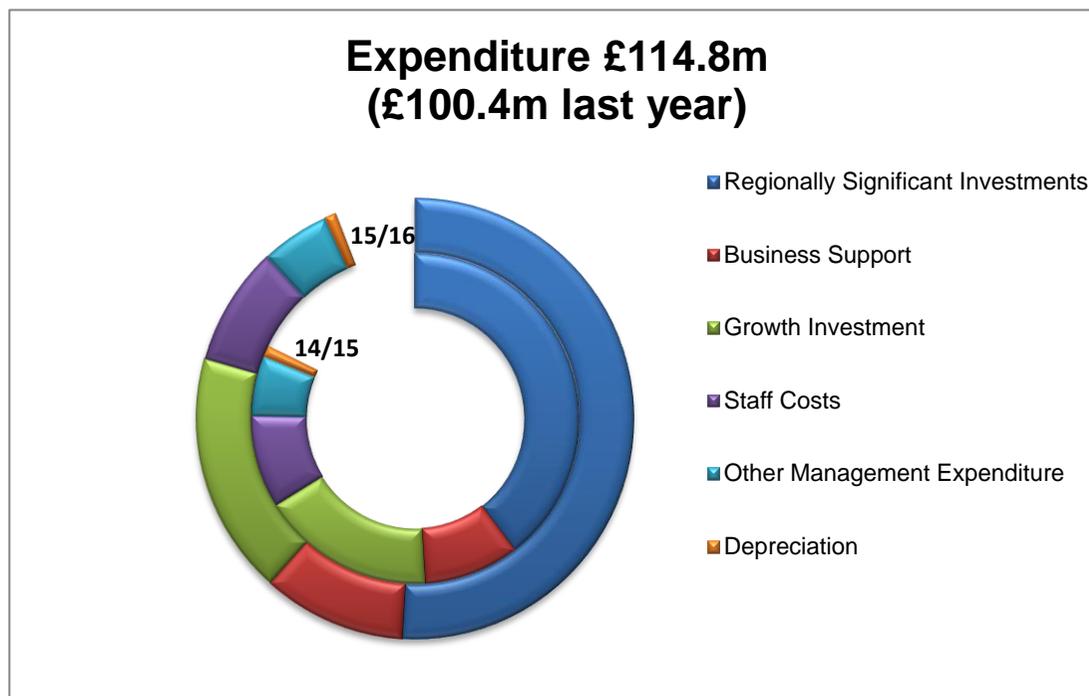
Best Value

- A performance management framework is in place with all performance measures achieved in 2015/16.
- The recommendations in the report *Supporting Scotland's economic growth: The role of the Scottish Government and its economic development agencies* are being reviewed.

Introduction

1. This report is a summary of our findings arising from the 2015/16 audit of Highlands and Islands Enterprise.
2. The management of Highlands and Islands Enterprise 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](#) and [appendix III](#).
6. [Appendix IV](#) 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 the Highlands and Islands Enterprise understands its risks and has arrangements in place to manage them. The Risk and Assurance 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.

Audit of the 2015/16 financial statements



The financial statements show that total income and funding of £113.8 million, including non-cash department expenditure limit funding of £2.02 million, is £13.6 million (14%) more than last year. Grant in aid increased by £5.5 million (9%) due to the additional Wave Energy Scotland funding. Scottish Government receipts have increased by £10.8 million as a result of the broadband funding arrangement which is also partly responsible for the increase in expenditure within regionally significant investments.

Highlands and Islands Enterprise remains within its expenditure limits, as the accounting basis includes non cash expenditure items that are covered by annual managed expenditure budget cover.

Audit opinions

Financial Statements

- The financial statements of Highlands and Islands Enterprise for 2015/16 give a true and fair view of the state of affairs of the body and its group and of their net expenditure for the year.
- The financial statements have been properly prepared in accordance with the 2015/16 FReM and the requirements of the Enterprise and New Towns (Scotland) Act 1990 and directions made by the Scottish Ministers.

Regularity

- 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

- The part of the Remuneration Report to be audited has been properly prepared in accordance with the Enterprise and New Towns (Scotland) Act 1990 and directions made by the Scottish Ministers.
- The information given in the performance report is consistent with the financial statements.

Submission of financial statements for audit

9. We received the unaudited financial statements on 24 June 2016, in accordance with the agreed timetable along with a completed NAO disclosure checklist. The annual report largely reflected the new FReM requirements. The core financial statements provided to audit were of a good standard, however some note disclosures required significant amendment and rework to ensure they were accurately presented. 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 28 July 2016.

Overview of the scope of the audit of the financial statements

10. 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 Risk and Assurance Committee on 29 March 2016. 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 £129,500 and, as we did not carry out any work additional to our planned audit activity, the fee remains unchanged.
11. 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

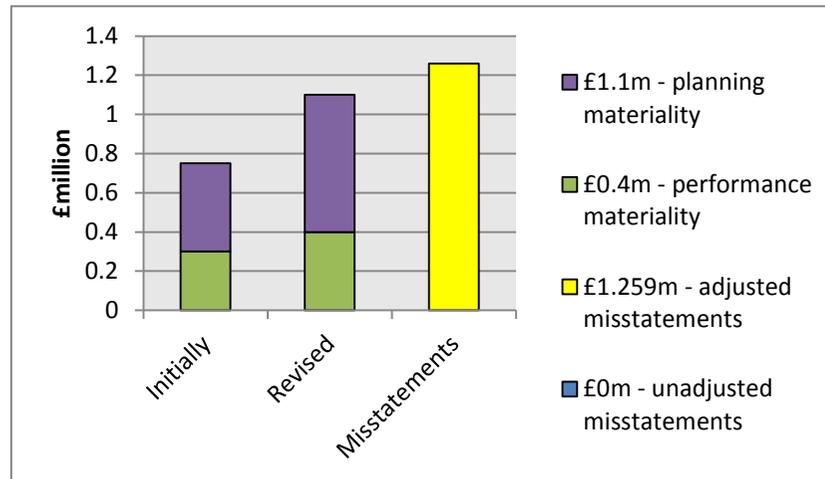
strategy, resources and effort. We set out in our Annual Audit Plan the audit work we proposed to undertake to secure appropriate levels of assurance.

12. [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.
13. 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

14. We consider materiality and its relationship with audit risk when planning the nature, timing and extent of our audit and conducting our audit programme. Specifically with regard to the financial statements, we assess the materiality of uncorrected misstatements, both individually and collectively.
15. 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 £1.1 million (1% of gross expenditure). 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 £0.4 million (i.e. 40% of materiality). We report all misstatements greater than £0.02 million.

Exhibit 1: Overall materiality misstatements



Evaluation of misstatements

- 16. The unaudited financial statements have been adjusted to address the 6 misstatements identified during the audit process. The gross value of adjustments was £1.259 million with the majority of the value relating to 2 adjustments for the depreciation charge for plant and equipment (£0.205 million), detailed in paragraph 23, and the elimination of Wave Energy Scotland balances (£0.88 million), detailed in paragraph 24.
- 17. The net impact of all adjustments is to decrease net expenditure by £0.011 million. There is no impact on the net asset position for Highlands and Islands Enterprise or the group.

- 18. The total adjustments exceeded our overall performance materiality level of £0.4 million and we considered the need to undertake further audit testing. We consider that the issues noted in paragraph 16 are isolated and 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

- 19. 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.
- 20. 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	
Disposal of investment in Wind Towers (Scotland) Ltd	
21.	<p>On 31st March 2016 Highlands and Islands Enterprise disposed of their investment in Wind Towers (Scotland) Ltd. The purchaser, CS Wind Corporation, paid Highlands and Islands Enterprise 20p for their 19.9% share ownership which they purchased in May 2011 for £3.4 million. A provision was provided, in full, against this amount in the financial statements, but we believe that the full amount should be disclosed as a loss in the losses statement within the accounts.</p> <p><i>The Scottish Government approved the sale agreement. The accounts have been updated to show the investment loss within the parliamentary accountability report.</i></p>
Support for CS Wind Corporation	
22.	<p>As part of the negotiated package for the sale of Wind Towers (Scotland) Ltd to CS Wind Corporation, a future infrastructure investment of £2.8 million has been agreed by Highlands and Islands Enterprise to develop the site. A key priority for Highlands and Islands Enterprise is to ensure ongoing tenancy on this site to support employment in the area and to cover the rental expenditure that is already committed by Highlands and Islands Enterprise under a head lease until 2051. The proposal included an assessment of the Market Economy Investor Principle to confirm that there were no potential state aid implications, this was based on the additional future rental that will be received from CS Wind Corporate. Highlands and Islands Enterprise also has an outstanding loan, matched by the parent body, which has been extended consistently by both parties.</p> <p><i>We have considered the audit evidence provided and concluded that there are no issues with the regularity of the transaction, based on the MEIP assessment.</i></p>

Significant findings from the audit in accordance with ISA260

Depreciation charge for plant and equipment

23. In April 2016 the plant and equipment that is owned by Highlands and Islands Enterprise, but leased to Wind Towers (Scotland) Ltd, was sold to CS Wind Corporation for £1.9 million. The accounts include these assets as held for sale and recognise a loss on remeasurement of £0.4 million due to the agreed purchase price, which represents fair value. Finance officers identified that no depreciation had been charged on this plant and equipment for the 2015/16 financial year even though they were only transferred to held for sale in March 2016.

The accounts have been adjusted to include the plant and equipment depreciation of £0.205 million.

Elimination of Wave Energy Scotland balances

24. The transactions for Wave Energy Scotland are currently processed via the financial ledger of Highlands and Islands Enterprise. The unaudited accounts for Highlands and Islands Enterprise contained payables and receivables balances totalling £0.88 million which related to Wave Energy Scotland and therefore should not have been included in the single entity statement of financial position.

The accounts have been adjusted to reduce the payables and receivables balance for Highlands and Islands Enterprise by £0.88 million. There was no impact on the net asset position of the group. It is important that there is a clear process to eliminate the balances for Wave Energy Scotland.

Appendix IV – Action Plan No. 1

Exit packages

25. During 2015/16 a decision was made to close the H&I European Partnership, based in Brussels, resulting in 2 members of staff being offered redundancy packages. Belgian redundancy protection required significant notice periods (17 and 22 months) and a decision was made to give payment in lieu of notice. The redundancy was paid outwith Highlands and Islands Enterprise's normal policy and approval was obtained from the Scottish Government.

The exit packages are correctly disclosed in the accounts and were appropriately approved based on legal advice relevant to Belgium.

Future accounting and auditing developments

Code of Audit Practice

26. A new Code of Audit Practice has now been published and will apply to public sector audits for financial years starting on or after 1 April 2016. The Code is a key part of the overall framework for the conduct of public audit in Scotland and increases the transparency of public sector audit work by making more 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 irrespective of whether the body meets in public or makes documents such as committee papers routinely available on its own website.
27. Also, under the new Code, appointed auditors are required to provide conclusions on the four dimensions of wider-scope public audit: financial sustainability; financial management; governance and transparency; and value for money.

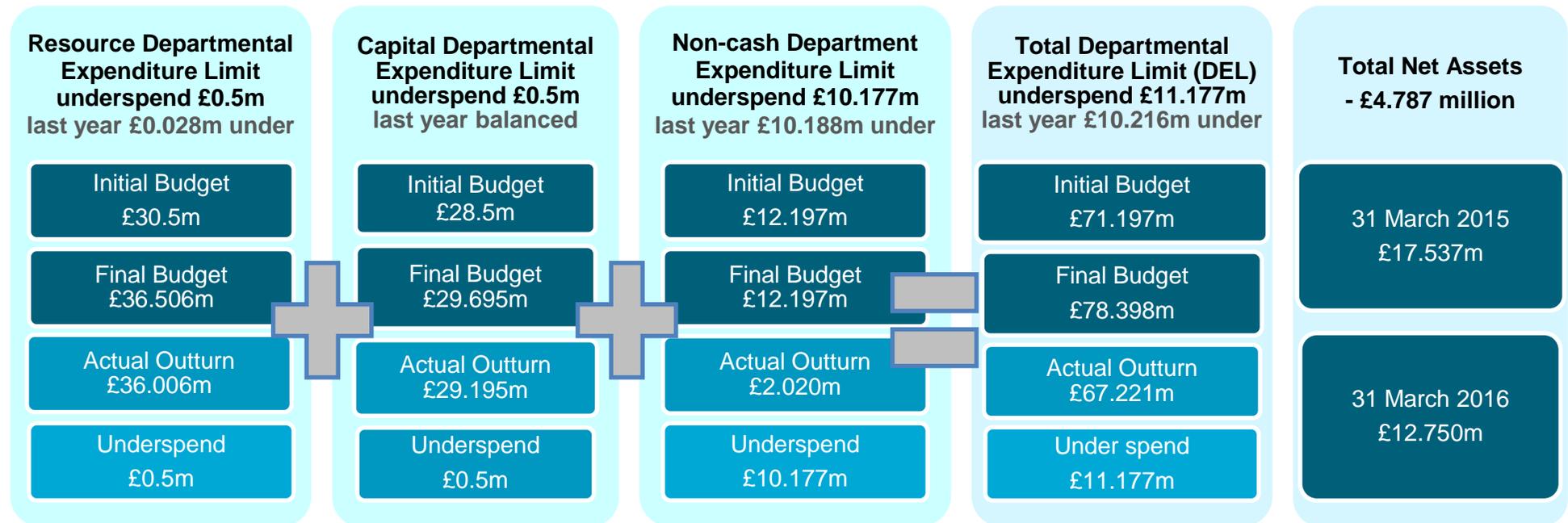
Audit appointment from 2016/17

28. 2015/16 is the final year of the current five year audit appointment. From 2016/17 the auditor of Highlands and Islands Enterprise will be Audit Scotland, however Angela Cullen will replace Brian Howarth as the appointed auditor. In accordance with agreed protocols and International Standards on Auditing we will be liaising with the incoming auditors as part of this transition.

Public Sector Internal Auditing Standard

29. The Chartered Institute of Public Finance and Accountancy (CIPFA) has issued a revised Public sector internal auditing standard (PSIAS). We will assess Highlands and Islands Enterprise's internal audit function against this revised standard as part of the 2016/17 audit process.

Financial sustainability



The £1 million underspend detailed above includes a £0.975 million contribution to the Scottish Government which is detailed at paragraph 32.

In addition to the above DEL budgets, an Annual Managed Expenditure (AME) budget of £9.4 million was provided and was underspent by £2.031 million. Highlands and Islands Enterprise first received an AME budget in 2011/12 and there was no associated decrease in the non-cash DEL budget provided by the Scottish Government. Highlands and Islands Enterprise therefore reports a significant annual underspend in non-cash DEL.

2015/16 financial outturn

30. The main financial objective for Highlands and Islands Enterprise is to ensure that the financial outturn for the year is within the budget allocated by Scottish Ministers.
31. Highlands and Islands Enterprise operated within the resource budgets for 2015/16 as detailed above. The final total DEL budget was £7 million (12%) higher than the initial budget due to the additional Wave Energy Scotland funding provided.

Surrender of funds to the Scottish Government

32. During 2015/16 the Scottish Government requested Highlands and Islands Enterprise to support other initiatives by surrendering some funding. The Scottish Government did not adjust the budget allocation and the support was provided by a reduction in the grant in aid drawn down during the year. The resource budget outturn, detailed above, includes a cash underspend for Highlands and Islands Enterprise of £1 million, with £0.975 million being the contribution to Scottish Government initiatives.

2015/16 financial position

33. The financial statements show that:
 - Highlands and Islands Enterprise group has net assets of £12.75 million a decrease of £4.8 million largely attributable to the disposal of property, plant and equipment and the increase in the pension liability

- Highlands and Islands Enterprise superannuation scheme has a deficit of £31.8 million and recovery plans are in place to address this shortfall, including lump sum employer contributions and increasing member contribution rates
- Highlands and Islands Enterprise group incurred positive net cash flows from operations (grant in aid allocation of £65.226 million vs £60.003 million net cash outflow from operating activities)
- There is an excess of current assets over current liabilities for both Highlands and Islands Enterprise and the group (and this has increased from last year).

Going concern

34. The First Minister announced on 25 May 2016 that “over the summer, we will also carry out an end-to-end review of the roles, responsibilities and relationships of our enterprise, development and skills agencies, covering the full functions of Scottish Enterprise, Highlands and Islands Enterprise, Skills Development Scotland and the Scottish Funding Council”. At this time, we don’t believe there is specific change in government policy affecting the existence of the body or the provision of enterprise funding. The total budget for enterprise agencies in 2016/17 is set out in the Budget Act and associated spending plans (<http://news.scotland.gov.uk/Speeches-Briefings/Priorities-speech-Taking-Scotland-Forward-24f8.aspx>).
35. We concur with management’s view that the going concern assumption remains appropriate.

2016/17 financial outlook

Financial planning

36. In June 2014, Audit Scotland reported on [Scotland's public finance](#) and the significant financial challenges ahead. The report 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 and contained 3 recommendations.



37. Furthermore in the [local government overview report](#) published in March 2016, Audit Scotland set out some key questions, which, although focused on local government bodies, can apply to all public sector bodies across Scotland.



38. These questions provide a framework for our assessment of the financial planning in Highlands and Islands Enterprise.

Table 2: Assessing financial planning

How fully do our financial plans identify estimated differences between income and expenditure (budget shortfall)?
<p>39. The Operating Plan 2016-2019 includes a rolling 3 year financial plan which assumes that Scottish Government funding will remain at the 2016/17 level in subsequent years (£67.2 million including non-cash funding) and income (£12.3 million) that is matched by the planned expenditure (£79.5 million). The baseline grant in aid of £56.2 million represents a 6% reduction on the initial budget for 2015/16. The 2016/17 budget was approved by the Board in April and shows a negative reserve requirement of £3.6 million which is consistent with prior years and reflects an established pattern to manage projects to achieve year end outturn. Income within the budget includes European funds of £5 million which is significantly higher than the income that has been received in previous years (ranges from £2.2 million to £3.3 million).</p>

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?

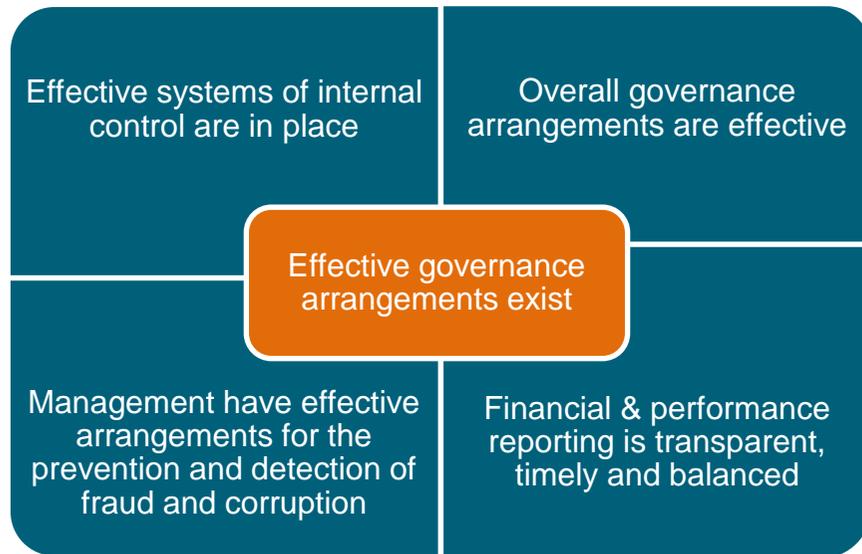
40. Highlands and Islands Enterprise has a well developed project approval process in place to ensure that expenditure is managed within the available funding limits.

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?

41. Highlands and Islands Enterprise currently prepares a three-year operating plan (2016-2019) which includes stable financial forecasts for income and expenditure. Supporting financial plans over a longer period are not established.

Appendix IV – Action Plan No. 2

Governance and transparency



Corporate governance

42. Highlands and Islands Enterprise is managed by a Board, including non-executive directors, and is accountable through the Scottish Ministers to the Scottish Parliament. The Board's Chair and non-executives are appointed by Scottish Ministers. During 2015/16 the Board, of 10 Members including the Chairman, was supported in its role by the Risk and Assurance Committee and the Remuneration

Committee. The committees meet on a regular basis to consider relevant matters.

43. The Accountable Officer is responsible for establishing arrangements for ensuring the proper conduct of the affairs of Highlands and Islands Enterprise and for monitoring the adequacy of these arrangements.
44. We concluded that Highlands and Islands Enterprise has effective overarching and supporting governance arrangements which provide an appropriate framework for decision making.

Financial management

45. 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 and Corporate Services 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
 - Risk and Assurance Committee members provide a good level of challenge and question officers on significant issues.

46. Based on our accumulated knowledge, including our review of Leadership Team papers and through our attendance at the Risk and Assurance Committee we conclude that Highlands and Islands Enterprise has strong financial management arrangements in place.

Transparency

47. The Scottish Government's [On Board](#) guidance for board members of public bodies was updated and reissued in April 2015 and contains a number of recommendations for boards to consider including:
- holding board meetings in public unless there is a good reason not to
 - publishing summary reports and/or minutes of meetings
 - consulting stakeholders and users on a wide range of issues
 - making corporate plans and the annual report widely available.
48. Last year we reported that Highlands and Islands Enterprise could do more to improve their openness and transparency. We can confirm that the website now contains minutes of all Board meetings and Risk and Assurance Committee meetings which provides increased transparency.
49. The website is a key mechanism for sharing strategies and enabling members of the public to develop a better understanding of the work of Highlands and Islands Enterprise. It also contains registers of interest for all Board and Leadership Team members, however the information disclosed is not always kept up to date.

50. Overall we concluded that Highlands and Islands Enterprise has taken steps to improve their openness and transparency, however the arrangements should be kept under review to ensure the website is updated as soon as agreed minutes are available.

Internal control

51. No material weaknesses in the accounting and internal control systems were identified during the 2015/16 audit which could adversely affect the organisation's ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements of Highlands and Islands Enterprise and its group.
52. We identified a few opportunities for controls to be strengthened and we reported our findings to the Director of Finance and Corporate Services on 28 April 2016 and the Risk and Assurance Committee on 7 June 2016. The key finding related to formalising the approval requirements for payments within larger projects that have already been approved in accordance with the scheme of delegation.

Internal audit

53. Internal audit provides the Risk and Assurance 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.

54. Our review of internal audit concluded that the business improvement and internal audit service operates in accordance with the Public Sector Internal Audit Standards (PSIAS) and has sound documentation standards and reporting procedures in place. The internal audit plan for 2015/16 is materially complete and we were able to place formal reliance on aspects of internal audit work on significant transactions and certificates of assurance.

Arrangements for the prevention and detection of fraud

55. Highlands and Islands Enterprise is responsible for establishing arrangements to prevent and detect fraud and other irregularity. We reviewed these arrangements and have concluded that there are effective arrangements for the prevention and detection of fraud.

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

56. 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 Highlands and Islands Enterprise.

Correspondence referred to the auditor by Audit Scotland

57. During 2015/16 we received two items of correspondence. The first instance was forwarded to the Highlands and Islands Enterprise Chief Executive for appropriate follow up as there was no audit action required. In the other case we looked at the procurement and other arrangements surrounding the Scotland Can Do SCALE scheme which is funded by a partnership between Highlands and Islands Enterprise, Scottish Enterprise and the Scottish Funding Council. We are currently discussing the scheme and will respond to the correspondent in due course.

Best Value

Arrangements for securing Best Value

58. Accountable officers have a specific responsibility to ensure that arrangements have been made to secure Best Value.
59. Highlands and Islands Enterprise developed their CREATIVE vision following consideration of a range of best practice models and guidance. The CREATIVE characteristics are detailed in the Operating Plan 2016-2019 with the aim of embedding best value and continuous improvement within all activities.
60. During 2015/16 Highlands and Islands Enterprise completed a benchmarking visit to Scottish Water to identify areas where the risk management arrangements could be strengthened. A risk action tracker has been introduced to support the active management and ownership of risks.

Performance measures 2015/16

61. In 2015/16 Highlands and Islands Enterprise achieved the 7 key measures outlined in the Operating Plan 2015-2018. The outturn for a number of the measures significantly exceeded the target range, particularly the increase in turnover and international sales by supported businesses. This indicates a strong performance in year but also an opportunity for the targets to be reviewed to ensure that these remain challenging.

Performance management

62. Highlands and Islands Enterprise's performance framework is derived from the Scottish Government's National Performance Framework. The Operating Plan 2016-2019 confirms the four key priorities of supporting businesses and social enterprises to shape and realise their growth aspirations; strengthening communities and fragile areas; developing growth sectors, particularly distinctive regional opportunities and creating the conditions for a competitive and low-carbon region.

Local performance audit work

Workforce planning

63. Audit Scotland published the report [Scotland's Public Sector Workforce](#) in November 2013. We carried out a follow-up audit at Highlands and Islands Enterprise in March 2016, based on the recommendations in the report.
64. Highlands and Islands Enterprise has an HR Team Plan 2014-17 which covers a range of strategic areas including workforce development, recruitment and learning and development. To support this a strategic review of resources was undertaken to consider key aspects of resource management including retention, succession planning and resource gap identification. Workforce plans and recruitment updates are regularly provided to the Leadership Team.

National performance audit reports

65. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2015/16, a number of reports were issued as outlined in [Appendix III](#).
66. Highlands and Islands Enterprise has processes in place to ensure that all relevant national performance reports are considered by the Risk and Assurance Committee.

Superfast broadband for Scotland: A progress report

67. Highlands and Islands Enterprise has reflected on the findings of the report and built on the existing arrangements to ensure the successful delivery of the project. They continue to work closely with the Scottish Government to deliver on the commitment for superfast broadband. The take-up is ahead of forecast and continuing to rise which has led to the release of early gainshare which will be used to provide additional rollout during 2017.
68. Highlands and Islands Enterprise is continually reviewing the work programme and payment profiles to ensure that claims reflect the targets achieved. Staffing levels are also kept under review based on the workload involved. Information is provided to the Scottish Government on project outcomes to enable overall monitoring of progress.
69. A further report is due to be published in August 2016 and Highlands and Islands Enterprise should review the report and any recommendations.

Supporting Scotland's economic growth: The role of the Scottish Government and its economic development agencies

70. In July 2016 Audit Scotland published the report [Supporting Scotland's economic growth: The role of the Scottish Government and its economic development agencies](#) focusing on the role of Scottish Enterprise and Highlands and Islands Enterprise in supporting the delivery of the Scottish Government's economic strategy and priorities. The report reviewed how they:



- work with the Scottish Government to determine their individual priorities
 - prioritise and make decisions on their spending and activity
 - work with partners to support economic growth
 - measure the impact of their activity.
71. The report noted that Highlands and Islands Enterprise has a distinct geography and additional remit to support communities which impacts on its customers and the rationale for support. There are clear, evidence-based strategies to prioritise spending and activities and good examples of partnership working to achieve a positive impact. There are also good governance and accountability arrangements in place to help inform the spending decisions and manage risks.
 72. The report sets out a number of recommendations for the Scottish Government and its partners including the enterprise bodies,

specifically it recommends that the Scottish Government, Highlands and Islands Enterprise and Scottish Enterprise should:

- consider how they can best support the delivery of the economic strategy
 - agree common performance measures, where appropriate, that are clearly aligned to the national performance framework
 - regularly review whether their support continues to add value.
73. Highlands and Islands Enterprise are reflecting on the recent report to identify any actions that are required taking into account the ongoing Scottish Government review outlined in paragraph 34.

Appendix I: Significant audit risks

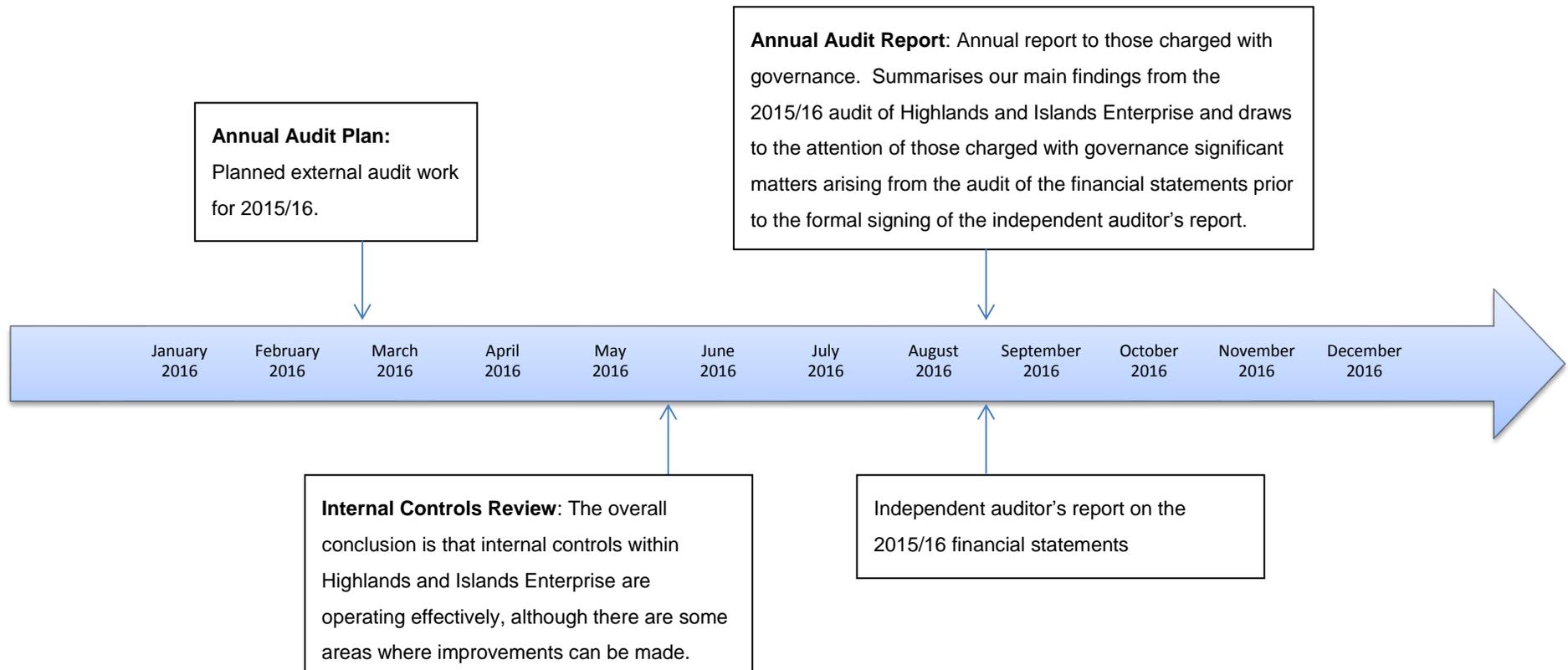
The table below sets out the audit risks we identified during the course of the audit and how we addressed each risk in arriving at our opinion on the financial statements.

Audit Risk	Assurance procedure	Results and conclusions
Risk of material misstatement		
<p>Management override of controls</p> <p>ISA240 requires that audit work is planned to consider the risk of fraud, which is presumed to be a significant risk in any audit. This includes consideration of the risk of management override of controls in order to change the position disclosed in the financial statements.</p>	<ul style="list-style-type: none"> • Detailed testing of journal entries. • Review of accounting estimates for bias. • Evaluating significant transactions that are outside the normal course of business. 	<p>We undertook detailed testing of journal entries, accruals and prepayments. We also reviewed accounting estimates and significant transactions for appropriateness.</p> <p>We did not identify incidence of management override of controls affecting the year-end position.</p>
<p>Income</p> <p>ISA240 requires auditors to presume a risk of fraud where income streams are significant. In 2015/16, Highlands and Islands Enterprise is expected to receive around £39.4 million from other sources, including other income and European funding.</p>	<ul style="list-style-type: none"> • We will perform controls testing over the accounts receivable system to confirm that the revenue recognition procedures are working effectively. • We will perform substantive testing of income to ensure that income has been recognised appropriately. 	<p>Our controls testing did not identify any issues with Highlands and Islands Enterprise's revenue recognition procedures.</p> <p>We completed substantive testing of income streams and did not identify any evidence of fraudulent activity.</p>

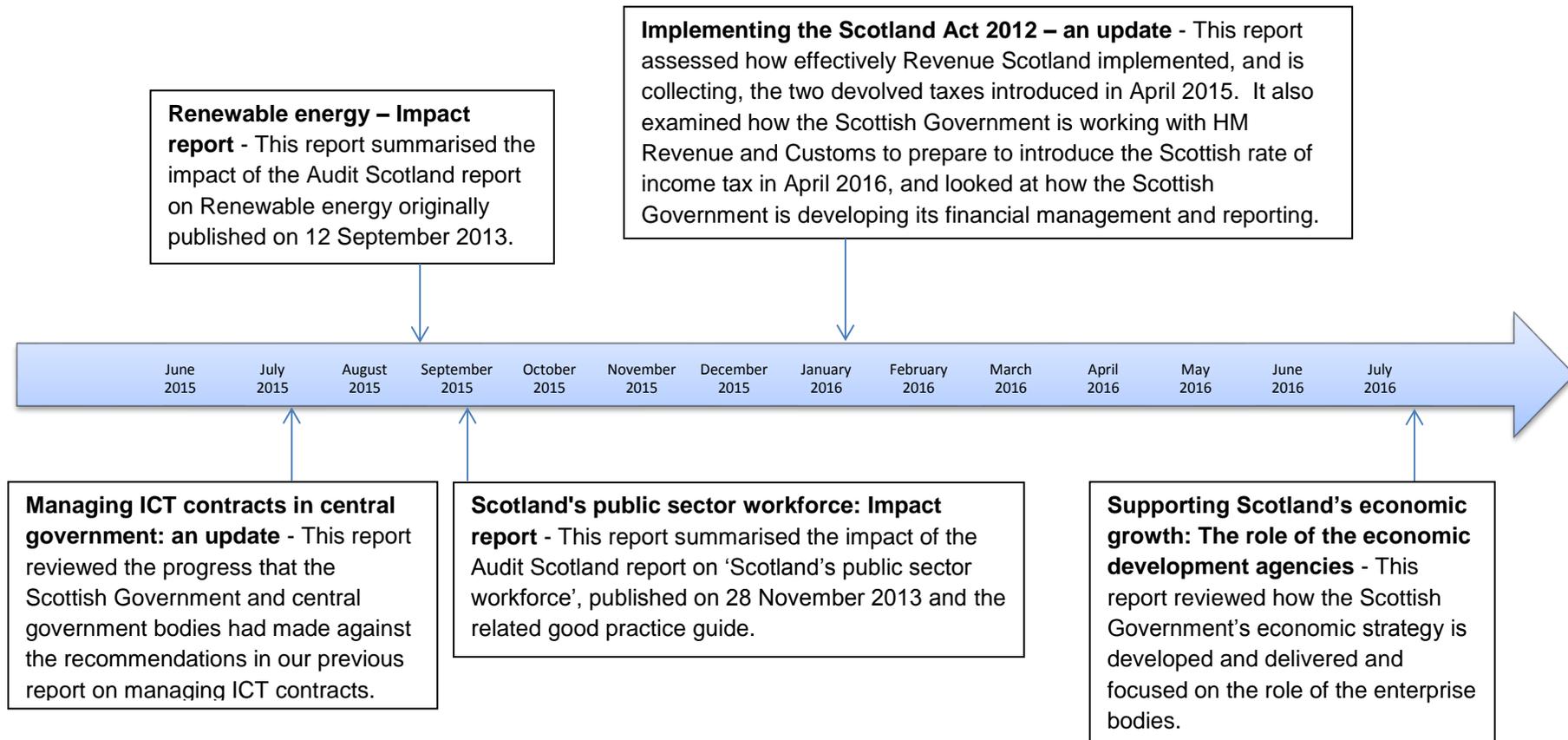
Audit Risk	Assurance procedure	Results and conclusions
<p>2015/16 Government Financial Reporting Framework changes</p> <p>The 2015/16 FReM has introduced changes that will affect the presentation and disclosure of Highlands and Islands Enterprise's 2015/16 financial statements. The most significant changes are:</p> <ul style="list-style-type: none"> • IFRS13 Fair value measurement • Restructuring of the annual report. <p>There is a risk that the financial statements do not contain the correct financial information and disclosure requirements.</p>	<ul style="list-style-type: none"> • Early discussion with finance officers on an agreed timetable for the preparation of the financial statements. • Completed FReM and NAO financial statements disclosure checklist will be subject to audit review. • FReM and NAO annual report disclosure checklist will be completed by audit. • Detailed testing of investments against IFRS13 requirements. 	<p>The unaudited accounts incorporated the changes required by the 2015/16 FReM.</p> <p>We reviewed NAO disclosures checklists that were provided with the unaudited accounts.</p> <p>Reviewed the disclosures in accordance with IFRS13 and concluded that they were satisfactory.</p>
<p>Wave Energy Scotland consolidation</p> <p>Wave Energy Scotland Ltd (WES) was established during 2014/15. It is a wholly owned subsidiary of Highlands and Islands Enterprise and was consolidated into the 2014/15 group accounts. For 2015/16 WES will have been in operation for the full financial year and will have increased transactions and balances at the year end. There is a risk this could increase the complexity of the consolidation process, leading to incorrect accounting.</p>	<ul style="list-style-type: none"> • Issue of the group questionnaire to the external auditor of Wave Energy Scotland Ltd. • We will carry out detailed testing of the consolidation process for the group financial statements. 	<p>We obtained assurances from the auditors of Wave Energy Scotland Ltd and completed detailed testing of the consolidation process.</p> <p>Following an audit adjustment we are satisfied that the body is correctly accounted for in the group financial statements (paragraph 24).</p>

Audit Risk	Assurance procedure	Results and conclusions
Risks identified from the auditor’s wider responsibility under the Code of Audit Practice		
<p>Broadband follow-up</p> <p><i>Superfast broadband for Scotland: A progress report</i> was published in February 2015. The report made recommendations for Highlands and Islands Enterprise and the Scottish Government.</p>	<ul style="list-style-type: none"> • We will establish the actions set up to address the report recommendations. • We will establish Highlands and Islands Enterprise’s progress against the actions. 	<p>We reviewed updates on the superfast broadband project and discussed progress with key officers.</p> <p>The project is progressing and is subject to ongoing reporting to the Strategic Board.</p>

Appendix II: Summary of local audit reports 2015/16



Appendix III: Summary of Audit Scotland national reports 2015/16



Appendix IV: Action plan

No.	Paragraph ref.	Issue / Risk / Recommendation	Management action / Response	Responsible officer / Target date
1.	24	<p>Issue: The audit process identified £0.88 million payables and receivables balances within the single entity statement of financial position that were actually Wave Energy Scotland balances.</p> <p>Risk: There is a risk that the accounts of Highlands and Islands Enterprise and Wave Energy Scotland do not accurately reflect the correct balances.</p> <p>Recommendation: The process should be reviewed to ensure all Wave Energy Scotland balances are correctly categorised.</p>	During 2016/17 we will be implementing a new process for Wave Energy Scotland transactions. This revised process will not require the Wave Energy Scotland transactions to be processed via the Highlands and Islands Enterprise financial ledger.	Andrew Jenkins, Head of Finance Services 31 March 2017

No.	Paragraph ref.	Issue / Risk / Recommendation	Management action / Response	Responsible officer / Target date
2.	41	<p>Issue: Highlands and Islands Enterprise currently prepares 3 year rolling budgets which are published within the operating plan.</p> <p>Risk: There is a risk that financial planning does not fully consider long term implications and scenarios.</p> <p>Recommendation: A long term financial strategy (> 5 years) should be developed and supported by detailed plans. The plans should be based on scenario planning to identify the potential budget impact on future decisions.</p>	<p>Highlands and Islands Enterprise currently adopts a rolling 3 year financial plan which reflects both the government funding profile and a reasonable certainty profile of current commitment and projects. We can understand why a longer term time frame may be proposed, but having considered this in the past and recognising the nature of our funding and volatility of project profiles and spend this did not provide any enhanced clarity or certainty beyond year 3. However, in the current circumstances Highlands and Islands Enterprise will reflect on this and establish if anything has changed and assess whether a 5 year rolling plan will be beneficial in terms of financial planning.</p>	<p>Director of Finance and Corporate Services 31 March 2017</p>