

# Highlands and Islands Enterprise

Annual Audit Plan 2019/20



 AUDIT SCOTLAND

Prepared for Highlands and Islands Enterprise

February 2020

## Who we are

The Auditor General, the Accounts Commission and Audit Scotland work together to deliver public audit in Scotland:

- the Auditor General is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit the Scottish Government, NHS and other bodies and report to Parliament on their financial health and performance
- the Accounts Commission is an independent public body appointed by Scottish ministers to hold local government to account. The Controller of Audit is an independent post established by statute, with powers to report directly to the Commission on the audit of local government
- Audit Scotland is governed by a board, consisting of the Auditor General, the chair of the Accounts Commission, a non-executive board chair, and two non-executive members appointed by the Scottish Commission for Public Audit, a commission of the Scottish Parliament.



## About us

Our vision is to be a world-class audit organisation that improves the use of public money.

Through our work for the Auditor General and the Accounts Commission, we provide independent assurance to the people of Scotland that public money is spent properly and provides value. We aim to achieve this by:

- carrying out relevant and timely audits of the way the public sector manages and spends money
- reporting our findings and conclusions in public
- identifying risks, making clear and relevant recommendations.

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# Risks and planned work

1. This annual audit plan contains an overview of the planned scope and timing of our audit which is carried out in accordance with International Standards on Auditing (ISAs), the [Code of Audit Practice](#), and Audit Scotland's [guidance on planning the audit](#). This plan sets out the work necessary to allow us to provide an independent auditor's report on the annual report and accounts and meet the wider scope requirements of public sector audit.

2. The wider scope of public audit contributes to assessments and conclusions on financial management, financial sustainability, governance and transparency, and value for money.

## Adding value

3. We aim to add value to Highlands and Islands Enterprise (HIE) through our external audit work by being constructive and forward looking, by identifying areas for improvement and by recommending and encouraging good practice. In so doing, we help HIE promote improved standards of governance, better management and decision-making and more effective use of resources.

## Audit risks

4. Based on our discussions with staff, attendance at committee meetings and review of supporting information we have identified the following significant audit risks for our 2019/20 audit of HIE and its group. We have categorised these audit risks into financial statements risks and wider dimension risks. The key audit risks, which require specific audit testing, are detailed in [Exhibit 1](#).

## Exhibit 1 2019/20 significant audit risks

 Audit Risk	Source of assurance	Planned audit work
<b>Financial statements risks</b>		
<p>1 <b>Risk of material misstatement caused by management override of controls</b></p> <p>Auditing Standards require that audits are planned to consider the risk of material misstatement caused by fraud, which is presumed to be a significant risk in any audit. This includes the risk of management override of controls to change the position disclosed in the financial statements.</p>	<p>Owing to the nature of this risk, assurances from management are not applicable in this instance.</p>	<p>Testing of journal entries.</p> <p>Review of accounting estimates.</p> <p>Testing of accruals and prepayments.</p> <p>Cut-off testing, to ensure income and expenditure is recognised in the correct financial year.</p> <p>Evaluation of any significant transactions that are outside the normal course of business.</p>

 <b>Audit Risk</b>	<b>Source of assurance</b>	<b>Planned audit work</b>
<p><b>2 Risk of material misstatement caused by fraud in income recognition</b></p> <p>As set out in ISA 240, there is a presumed risk of fraud in the recognition of income. There is a risk that income may be misstated resulting in a material misstatement in the financial statements.</p> <p>HIE and its group received £16 million of income from sources other than the Scottish Government in 2018/19 and expects a similar amount in 2019/20. The extent, nature and complexity of this income means that there is an inherent risk of fraud.</p>	<p>Effective budgetary control arrangements are in place including monitoring of income and anti-fraud arrangements.</p>	<p>Review of HIE's anti-fraud arrangements.</p> <p>Walk-through of controls over income/receivables.</p> <p>Analytical procedures on income streams.</p> <p>Detailed testing of revenue transactions focusing on the areas of greatest audit risk including property income and EU income.</p> <p>Substantive cut-off testing of income to ensure that it has been recognised in the correct financial year.</p>
<p><b>3 Risk of material misstatement caused by fraud in expenditure</b></p> <p>As most public-sector bodies are net expenditure bodies, the risk of fraud is more likely to occur in expenditure. There is a risk that expenditure may be misstated resulting in a material misstatement in the financial statements.</p> <p>In 2018/19, HIE and its group recorded gross expenditure of £105 million. This includes a material level of grants to third parties. Given the extent, nature and complexity of expenditure, there is an inherent risk of fraud.</p>	<p>Effective budget monitoring by management and Board members.</p> <p>Effective fraud and whistleblowing arrangements.</p> <p>Internal Audit's review of significant transactions which includes large grant payments.</p> <p>Participation in the National Fraud Initiative (NFI).</p>	<p>Review HIE's anti-fraud arrangements.</p> <p>Walk-through of controls over payables.</p> <p>Substantive testing of expenditure transactions with reliance on internal audit's work on significant transactions.</p> <p>Substantive cut-off testing of expenditure to ensure that it has been recognised in the correct financial year.</p> <p>Assessment of the results from HIE's participation in the National Fraud Initiative (NFI). This will be considered for Audit Scotland's national report in due course.</p>
<p><b>4 Estimations and judgements</b></p> <p>ISA 540 is concerned with the auditor's responsibilities relating to accounting estimates and related disclosures in financial statements.</p> <p>There is a significant degree of subjectivity in the measurement and valuation of land and buildings (£34m), pension liabilities (£47m), and investments (£2m). There is also a degree of estimation and judgement in accrued expenditure (£6m), accrued income (£4m) and provisions (£14m).</p> <p>Estimates and judgements in these areas represent an increased risk of misstatement in the financial statements.</p>	<p>Pension liability and non-current asset valuations are supported by external professional advisers who are qualified in their field.</p> <p>Provisions are recognised when the group has a present legal or constructive obligation as a result of a past event, it is probable that an outflow of resources will be required to settle the obligations and the amount can be reliably estimated.</p> <p>Investments are supported by the necessary amortised cost or fair value calculation</p>	<p>Review the work of an expert for the professional valuers (pensions liabilities and non-current assets).</p> <p>Review management's assessment of the appropriateness of the assumptions used in the valuation of these assets and liabilities.</p> <p>Review the progress of the ongoing VAT enquiry.</p> <p>Substantive testing of year-end balances including the accounting treatment for VAT related liabilities and the impact on the accounts.</p>

 <b>Audit Risk</b>	<b>Source of assurance</b>	<b>Planned audit work</b>
	<p>under IFRS 9 principles and reviewed by HIE's investment manager</p> <p>Accruals are recognised for all late invoices which meet our accrual policy. Uninvoiced costs are accrued based on a review of services and goods received which have not been invoiced.</p>	
<p><b>5 Finance team capacity and expertise</b></p> <p>The nature of its business means that HIE accounts for complex transactions. In previous years we identified issues with how HIE accounts for these transactions and recommended a review to ensure there is sufficient skills and capacity within the finance team.</p> <p>The ongoing VAT enquiry, and financial support and advice for Cairngorm Mountain and other complex projects continues to put pressure on the finance team during 2019/20.</p> <p>Work is also required to assess the implications of IFRS 16 (Leases) and to ensure arrangements are in place to support its adoption in 2020/21.</p> <p>There is a risk that the finance team will not have the capacity or financial skills required to deliver the annual report and accounts to the agreed timetable and that complex transactions will not be accounted for correctly.</p>	<p>An annual accounts improvement plan has been prepared which includes a response to the issues raised regarding the Finance team. Progress against this is reported to the RAC regularly and there is a report going to the March meeting.</p>	<p>Regular meetings with the Director of Finance and Corporate Services to identify any issues in respect of the finance team's capacity and the impact on the preparation of the financial statements.</p> <p>Review the progress of the ongoing VAT enquiry and the implications for HIE's accounts.</p> <p>We will also engage with officers during our 2019/20 audit to assess preparations for the implementation of IFRS 16 (Leases) in 2020/21.</p>
<b>Wider dimension risks</b>		
<p><b>6 Financial sustainability</b></p> <p>HIE faces significant financial pressures in areas where there is uncertainty about the timing and amount of potential expenditure including costs associated with the Cairngorm funicular railway, the provision of working capital to Cairngorm Mountain (Scotland) Limited, the VAT enquiry and other major projects such as Spaceports.</p> <p>There is a risk that HIE is unable to deliver all of its financial commitments or achieve its</p>	<p>Regular budget monitoring, especially towards year-end.</p> <p>Regular financial performance reports to management and Board members.</p>	<p>Review financial monitoring reports and the financial position at the year-end including performance against resource limits set by the Scottish Government.</p> <p>Ongoing discussions with HIE about its financial position.</p>

 <b>Audit Risk</b>	<b>Source of assurance</b>	<b>Planned audit work</b>
<p>performance targets within its existing resource allocations.</p>		
<p><b>7 Governance and transparency - cyber security and business continuity planning</b></p> <p>Organisations are increasingly threatened by cyber-attacks. In August 2019, internal audit reviewed arrangements within EIS (HIE's shared IT arrangement with Skills Development Scotland (SDS) and Scottish Enterprise (SE)) and reported that there were key areas for improvement.</p> <p>In addition, HIE has yet to prepare business continuity plans for all its key locations.</p> <p>There is a risk that a cyber-attack or some other type of business interruption could disrupt HIE's systems, including its key financial systems.</p>	<p>A wider review of cyber strategy, led by EIS on behalf of the EIS shared services partners, is due to be completed by 31 March 2020.</p> <p>A draft Business Continuity Plan has been prepared for An Lochran and was recently tested. Once finalised, this will be used as a template for other offices to use to prepare local business continuity plans.</p>	<p>Review progress in addressing the recommendations raised by internal audit and co-ordinate our work with the external auditors of SDS and SE.</p> <p>Place reliance on any internal audit follow-up work.</p> <p>Review progress made in developing business continuity plans for all HIE's key locations.</p>
<p><b>8 Value for money</b></p> <p>HIE has developed a new Strategic Plan covering the period 2019-2022 to reflect significant changes in its internal and external operating environments.</p> <p>There is a risk that the new performance management arrangements are not aligned with the Enterprise and Skills Strategic Board's missions and that, as a result, HIE is unable to demonstrate progress and its contribution to the Scottish Government's National Performance Framework.</p>	<p>Regular Chief Executive's reports to the Board.</p> <p>Ongoing engagement with the Strategic Board and the Scottish Government.</p>	<p>Review HIE's Strategic Plan's alignment with the Enterprise and Skills Strategic Board's missions.</p> <p>Consider the impact of the Strategic Board's strategic plan on HIE's performance management arrangements, in particular whether appropriate measures are in place to report on achievement of its objectives.</p>

Source: Audit Scotland

## Reporting arrangements

**5.** Audit reporting is the visible output from the annual audit. All annual audit plans, other outputs as detailed in [Exhibit 2](#), and any other outputs on matters of public interest will be published on our website: [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk).

**6.** Matters arising from our audit will be reported on a timely basis and will include agreed action plans. Draft management reports will be issued to the relevant officer to confirm factual accuracy.

**7.** We will provide an independent auditor's report to HIE, the Scottish Parliament and the Auditor General for Scotland setting out our opinions on the annual report and accounts. We will also provide an annual report on the audit containing observations and recommendations on significant matters which have arisen during the audit.

## Exhibit 2

### 2019/20 audit outputs

Audit Output	Target date	Committee date
Annual Audit Plan	25 February 2020	3 March 2020
Management Report	26 May 2020	2 June 2020
Annual Audit Report and proposed Independent Auditor's Report	4 August 2020	11 August 2020
Independent Auditor's Report (signed)	11 August 2020	N/A

Source: Audit Scotland

### Audit fee

**8.** The agreed audit fee for the 2019/20 audit of HIE is £137,970 (2018/19 agreed fee £136,160). In determining the audit fee, we have taken account of the risk exposure of HIE, the planned management assurances in place and the level of reliance we plan to take from the work of internal audit. Our audit approach assumes receipt of the unaudited annual report and accounts together with a complete working papers package by 15 June 2020.

**9.** Where our audit cannot proceed as planned through, for example, late receipt of the unaudited annual report and accounts, inefficiencies and time over-runs arising from changes to the annual report and accounts at the conclusion of the audit or being unable to take planned reliance from the work of internal audit, a supplementary fee may be levied. An additional fee may also be required in relation to any work or other significant exercises outwith our planned audit activity.

### Responsibilities

#### Risk and Assurance Committee and Interim Accountable Officer

**10.** Audited bodies have the primary responsibility for ensuring the proper financial stewardship of public funds, compliance with relevant legislation and establishing effective arrangements for governance, propriety and regularity that enable them to successfully deliver their objectives.

**11.** The audit of the annual report and accounts does not relieve management or the Risk and Assurance Committee, as those charged with governance, of their responsibilities.

#### Appointed auditor

**12.** Our responsibilities as independent auditors are established by the Public Finance and Accountability (Scotland) Act 2000 and the Code of Audit Practice (including supplementary guidance) and guided by the Financial Reporting Council's Ethical Standard.

**13.** Auditors in the public sector give an independent opinion on the financial statements and other information within the annual report and accounts. We also review and report on the arrangements within the audited body to manage its performance, regularity and use of resources. In doing this, we aim to support improvement and accountability.

# Audit scope and timing

## Annual report and accounts

14. The annual report and accounts, which include the financial statements, will be the foundation and source for most of the audit work necessary to support our judgements and conclusions. We also consider the wider environment and challenges facing the public sector. Our audit approach includes:

- understanding HIE's business and the associated risks which could impact on the financial statements
- assessing the key systems of internal control, and establishing how weaknesses in these systems could impact on the financial statements
- identifying major transaction streams, balances and areas of estimation and understanding how HIE will include these in the financial statements
- assessing the risks of material misstatement in the financial statements
- determining the nature, timing and extent of audit procedures necessary to provide us with sufficient audit evidence as to whether the financial statements are free of material misstatement.

15. We will give an opinion on:

- whether the financial statements give a true and fair view of the financial position of HIE and its group as at 31 March 2020 and of their income and expenditure for the year then ended
- whether the financial statements have been properly prepared in accordance with relevant legislation, the applicable accounting framework and other reporting requirements
- the regularity of income and expenditure.

## Statutory other information in the annual report and accounts

16. We also review and report on statutory other information published within the annual report and accounts including the performance report, annual governance statement and the remuneration and staff report. We give an opinion on whether these have been compiled in accordance with the appropriate regulations and frameworks in our independent auditor's report.

17. We also review the content of the annual report for consistency with the financial statements and with our knowledge. We report any uncorrected material misstatements in statutory other information.

## Materiality

18. We apply the concept of materiality in planning and performing the audit. It is used in evaluating the effect of identified misstatements on the audit, and of any uncorrected misstatements on the financial statements and in forming our opinions in the independent auditor's report.

19. We calculate materiality at different levels as described below. The calculated materiality values for HIE and its group are set out in [Exhibit 3](#).



characteristics



responsibilities



principal activities



risks



governance arrangements

## Exhibit 3

### Materiality values

Materiality	Amount
<b>Planning materiality</b> – this is the figure we calculate to assess the overall impact of audit adjustments on the financial statements. It has been set at 1% of the group's gross expenditure for the year ended 31 March 2019 based on the 2018/19 audited accounts.	£1.05 million
<b>Performance materiality</b> – this acts as a trigger point. If the aggregate of errors identified during the financial statements audit exceeds performance materiality this would indicate that further audit procedures should be considered. Using our professional judgement, we have calculated performance materiality at 40% of planning materiality.	£420,000
<b>Reporting threshold (i.e. clearly trivial)</b> – we are required to report to those charged with governance on all unadjusted misstatements more than the 'reporting threshold' amount. This has been calculated at 5% of planning materiality.	£50,000

Source: Audit Scotland

## Timetable

**20.** To support the efficient use of resources it is critical that a timetable is agreed with us for the audit of the annual report and accounts. [Exhibit 4](#) sets out the agreed timetable which takes account of submission requirements and planned Risk and Assurance Committee dates.

**21.** The timetable for the financial statements audit is challenging for HIE and the audit team. We plan our audits carefully to ensure efficient deployment of staff and so it is key that a complete set of unaudited accounts is submitted for audit by the agreed date.

## Exhibit 4

### Annual report and accounts timetable

 Key stage	 Date
Latest submission date of unaudited annual report and accounts with complete working papers package	15 June 2020
Latest date for final clearance meeting with Director of Finance and Corporate Services	31 July 2020
Agreement of audited unsigned annual report and accounts and issue of draft Annual Audit Report to those charged with governance	4 August 2020
Independent auditor's report signed	11 August 2020
Latest date for signing the WGA return	30 September 2020

## Internal audit

**22.** Internal audit is provided by HIE's in-house internal audit team supported by a contract with Scott-Moncrieff to provide specialist and additional resources as required. In addition, HIE has developed a joint plan with the internal auditors of Scottish Enterprise (SE) and Skills Development Scotland (SDS) to obtain assurances over the operation of Enterprise Information Systems (EIS) which delivers ICT services to all three bodies.

**23.** As part of our planning process we carried out an assessment of the internal audit function to ensure that it operates in accordance with the main requirements of the Public Sector Internal Audit Standards (PSIAS). We concluded that, overall, HIE's in-house service operates in accordance with PSIAS and has sound documentation and reporting procedures in place. The requirement to comply with PSIAS is built in to all outsourced internal audit services including those jointly tendered with SDS and SE

### Using the work of internal audit

**24.** Auditing standards require internal and external auditors to work closely together to make best use of available audit resources, and we seek to rely on the work of internal audit, wherever possible, to avoid duplication. As in previous years, we intend to place formal reliance on internal audit's work on significant transactions.

**25.** In respect of our wider dimension audit responsibilities we also plan to consider other areas of internal audit work including:

- procurement
- certificates of assurance and governance statement.

**26.** We will also consider the internal audit arrangements for EIS which delivers ICT services to HIE, SDS and Scottish Enterprise.

## Audit dimensions

**27.** Our audit is based on four audit dimensions that frame the wider scope of public sector audit requirements as shown in [Exhibit 5](#).

### Exhibit 5 Audit dimensions



## Financial management

**28.** Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively. We will review, conclude and report on the following over our period of appointment:

- whether arrangements are in place to ensure systems of internal control are operating effectively
- the effectiveness of budgetary control system in communicating accurate and timely financial performance can be demonstrated
- how HIE has assured itself that its financial capacity and skills are appropriate
- whether there are appropriate and effective arrangements in place for the prevention and detection of fraud and corruption.

**29.** As part of our 2019/20 audit we will assess the risk of fraud and corruption in HIE's procurement function. We will consider the controls around the procurement process, whether appropriate training is provided to staff to assist in the recognition of fraud, and any findings from internal audit.

## Financial sustainability

**30.** As auditors we consider the appropriateness of the use of the going concern basis of accounting as part of the annual audit. We will also comment on financial sustainability in the longer term. We define this as medium term (two to five years) and longer term (longer than five years) sustainability. We will review, conclude and report on the following over our period of appointment:

- the effectiveness of financial planning in identifying and addressing risks to financial sustainability in the short, medium and long term
- the appropriateness and effectiveness of arrangements in place to address any identified funding gaps
- whether HIE can demonstrate the affordability and effectiveness of its funding and investment decisions.

## Governance and transparency

**31.** Governance and transparency are concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision-making and transparent reporting of financial and performance information. We will review, conclude and report on the following over our period of appointment:

- whether HIE can demonstrate that the governance arrangements in place are appropriate and operating effectively (including services delivered by, or in partnership with, others such as the EIS partnership)
- whether there is effective scrutiny, challenge and transparency of decision-making and finance and performance reports
- the quality and timeliness of financial and performance reporting.

**32.** As part of our 2019/20 audit, we plan to review how HIE demonstrates compliance with the Equality Act 2010, and how it is advancing equalities both within and outwith the organisation.

## Value for money

**33.** Value for money refers to using resources effectively and continually improving services. Over the course of our appointment we will review, conclude and report on whether:

- HIE can provide evidence that it is demonstrating value for money in the use of its resources
- there is a clear link between money spent, output and outcomes delivered
- outcomes are improving
- there is sufficient focus on improvement and the pace of it.

**34.** The Enterprise and Skills Strategic Board published its strategic plan in October 2018. This plan sets out four ‘missions’ together with a number of inter-related actions and recommendations. HIE and the other agencies are required to align their objectives with these missions.

**35.** In its May 2019 [Enterprise and Skills Review Briefing](#), Audit Scotland reported that in relation to performance monitoring, it was important for the agencies to be able to demonstrate that:

- actions are being implemented and are having the desired effect
- the pace of change is appropriate
- new or revised performance measures are aligned with the National Performance Framework.

**36.** As part of our 2019/20 audit, we plan to review whether HIE’s Strategic Framework 2019-2022 aligns with the Enterprise and Skills Strategic Board’s missions. In addition, we will consider the impact of the Strategic Board’s strategic plan on HIE’s performance management arrangements including whether appropriate measures are in place to report on the achievement of its objectives.

### Best Value

**37.** HIE’s Interim Accountable Officer has a duty to ensure arrangements are in place to secure Best Value. We will review these arrangements as part of our 2019/20 annual audit.

### Independence and objectivity

**38.** Auditors appointed by the Accounts Commission or Auditor General must comply with the Code of Audit Practice and relevant supporting guidance. When auditing the financial statements auditors must also comply with professional standards issued by the Financial Reporting Council and those of the professional accountancy bodies. These standards impose stringent rules to ensure the independence and objectivity of auditors. Audit Scotland has robust arrangements in place to ensure compliance with these standards including an annual “fit and proper” declaration for all members of staff. The arrangements are overseen by the Director of Audit Services, who serves as Audit Scotland’s Ethics Partner.

**39.** The engagement lead (i.e. appointed auditor) for HIE is Gordon Smail, Audit Director. Auditing and ethical standards require the appointed auditor to communicate any relationships that may affect the independence and objectivity of audit staff. We are not aware of any such relationships pertaining to the audit of HIE.

### Quality control

**40.** International Standard on Quality Control (UK and Ireland) 1 (ISQC1) requires that a system of quality control is established, as part of financial audit procedures, to provide reasonable assurance that professional standards and regulatory and legal requirements are being complied with and that the independent auditor’s report or opinion is appropriate in the circumstances.

**41.** The foundation of our quality framework is our Audit Guide, which incorporates the application of professional auditing, quality and ethical standards and the Code of Audit Practice (and supporting guidance) issued by Audit Scotland and approved by the Auditor General for Scotland. To ensure that we achieve the required quality standards Audit Scotland conducts peer reviews and internal quality reviews. Additionally, the Institute of Chartered Accountants of Scotland (ICAS) have been commissioned to carry out external quality reviews.

**42.** As part of our commitment to quality and continuous improvement, Audit Scotland will periodically seek your views on the quality of our service provision. We welcome feedback at any time and this may be directed to the engagement lead.

# Highlands and Islands Enterprise

## Annual Audit Plan 2019/20

If you require this publication in an alternative format and/or language, please contact us to discuss your needs: 0131 625 1500 or [info@audit-scotland.gov.uk](mailto:info@audit-scotland.gov.uk)

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