

Highlands and Islands Enterprise

Management Report 2019/20



 AUDIT SCOTLAND

Prepared for Highlands and Islands Enterprise

June 2020

Audit findings

Introduction

1. This report summarises the key issues identified during the interim audit at Highlands and Islands Enterprise (HIE). This included testing of key controls within financial systems to gain assurance over the processes and systems used in preparing the financial statements. We will use the results to inform our approach to the audit of the 2019/20 financial statements.

2. Our responsibilities under Audit Scotland's [Code of Audit Practice](#) (the Code) require us to assess the system of internal control put in place by management. We seek to gain assurance that HIE:

- has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements
- has systems of internal control which provide an adequate means of preventing and detecting error, fraud or corruption
- complies with established policies, procedures, laws and regulations.

3. In addition, we discussed HIE's preparations for the introduction of IFRS 16 Leases with finance staff.

4. The Code also requires a 'wider dimension' audit. Our interim work focused on HIE's arrangements for preventing fraud in procurement and HIE's response to the National Fraud Initiative. We also followed up HIE's progress in addressing 'wider dimension' risks we reported last year.

5. Our substantive testing of income, expenditure and elements of staff costs is ongoing, and we will complete this as part of our year-end audit. Other work set out in our annual audit plan on: financial sustainability; cyber security/business continuity planning; arrangements for compliance with the Equalities Act 2010; and alignment of HIE's performance reporting with the Skills and Enterprise Board's Strategic Plan is also ongoing and we will report the results in our 2019/20 Annual Audit Report.

6. We appreciate that there is ongoing uncertainty and challenges for HIE as a result of the COVID-19 measures advised by the UK and Scottish Governments. We recognise the continuing uncertainty and the potential impact this may have on the annual accounts and audit processes. In particular, our audit approach may require further revision once we are clearer about the accounting and auditing issues which may emerge as a result of the response to the COVID-19 pandemic. We will continue to discuss the best way forward with HIE's finance staff, taking account of the implications and practical issues facing HIE and our audit team.

7. Any weaknesses identified represent those that have come to our attention during the course of normal audit work and therefore are not necessarily all the weaknesses that may exist. It is the responsibility of management to decide on the extent of the internal control system appropriate to HIE.

8. The contents of this report have been discussed with relevant officers to confirm factual accuracy. The co-operation and assistance we received during the course of our audit is gratefully acknowledged, particularly during this challenging time.

9. All our outputs and any matters of public interest will be published on our website: www.audit-scotland.gov.uk

Conclusions

10. Based on the interim audit work, we concluded that the key controls within HIE's main financial systems are operating satisfactorily and, as a result, we can take our planned assurances for the audit of the 2019/20 financial statements.

11. HIE has begun to identify and quantify its leases and held discussions with the Scottish Government and other public bodies on the appropriate accounting treatment in preparation for the introduction of IFRS16 Leases. More work is needed prior to the revised implementation date, 1 April 2021.

12. In terms of our 'wider dimension' audit work we concluded that HIE:

- has appropriate arrangements to mitigate the risk of fraud in procurement activities
- was pro-active in reviewing National Fraud Investigation matches and conducting the appropriate investigations. No frauds were identified but investigations noted 24 matches where duplicate payments totalling £39,104 had been made to suppliers. To date, HIE has recovered £28,057 (71.8%) of this amount.

13. One of the wider dimension risks in last year's Management Report has yet to be fully addressed as there continues to be significant delays in publishing minutes of Board and RAC meetings on HIE's website.

Main financial systems

14. During our 2019/20 interim audit we undertook the following work:

- walkthrough of the key controls identified for each of HIE's main financial systems (general ledger, payroll, cash and bank, accounts payable and accounts receivable) to assess whether the controls were operating as intended
- testing of key controls in operation within these systems including bank and feeder system reconciliations, controls over IT access and changes to standing data and supplier bank details.

15. In accordance with *ISA 330: the auditor's response to assessed risk*, our audit judgements are based on current year testing of controls and, where appropriate, prior year results. Our risk-based audit approach allows us to take a three-year cyclical approach to controls testing. This approach enables us to place reliance on previous years' audit work where controls remain unchanged and no significant weaknesses were identified. Where possible, we also place reliance on the work of internal audit to avoid duplication of effort.

16. We did not identify any key control weaknesses from our walkthrough and testing of the key controls in operation within HIE's main financial systems.

17. We plan to rely on Internal Audit's work on significant transactions to support our audit opinion on the financial statements. At the time of drafting this report, Internal Audit has not yet completed this work and so we will review this area as part of our year-end financial statements audit work.

Preparations for the introduction of IFRS16 Leases

18. The 2019/20 Government Financial Reporting Manual (FReM) requires IFRS 16 Leases, as adapted and interpreted by the FReM, to be applied to public sector bodies with effect from 1 April 2020. In our 2019/20 Annual Audit Plan we noted that early work would be required to assess the practical implications and to ensure arrangements were in place to support adoption of this IFRS.

19. Our interim audit work found that HIE has begun to identify and quantify leases and has held discussions with representatives at Scottish Government and other public sector bodies to agree the appropriate accounting treatment.

20. In response to COVID-19, the Financial Reporting Advisory Board (FRAB) has agreed to delay the implementation of IFRS16 until 1 April 2021. We will continue to monitor HIE's preparations for IFRS16 Leases.

Wider dimensions

Arrangements for preventing fraud in procurement

21. As part of our interim audit, we reviewed how HIE manages the risk of fraud in its procurement activities. Our review confirmed that HIE has controls in place to mitigate this risk including:

- well-established policies and procedures including the staff code of conduct, procurement strategy, fraud, bribery and corruption policy (including response plan), conflicts of interest and whistleblowing policies
- registers of gifts and hospitality which are regularly updated
- use of the Public Contracts Scotland portal for any contracts in excess of £50,000
- ongoing training for staff involved in procurement, including training on anti-bribery for all staff and 'procurement fraud red flags' training for all procurement staff from NHS Counter Fraud Services (as part of a contract to provide training on fraud prevention)
- use of the Scottish Government's Scottish Model of Procurement, the procurement process applied throughout the Scottish public-sector.

22. HIE has a central procurement team and takes part in the Procurement and Commercial Improvement Programme (PCIP) assessment undertaken by the Scottish Government Procurement Capability team. HIE scored 80% in the latest assessment in 2019, a significant improvement compared to 51% in 2016. In particular, HIE's response to how it counteracts fraud in procurement attained the maximum score available.

23. The 2018/19 National Fraud Initiative (NFI) exercise generated only one procurement match. This was investigated by internal audit and no fraud or error was found.

24. Based on our interim work, we concluded that HIE has appropriate arrangements in place to mitigate the risk of fraud in procurement activities. Internal audit has recently completed a review of procurement which will be reported to a future meeting of HIE's Risk and Assurance Committee. We will review internal audit's report and consider the impact on our interim conclusion as part of our preparation of the Annual Audit Report.

Response to the National Fraud Initiative

25. The National Fraud Initiative (NFI) in Scotland is a counter-fraud exercise coordinated by Audit Scotland. It uses computerised techniques to compare information about individuals held by different public bodies, and on different financial systems, to identify 'matches' that might suggest fraud or irregularity.

26. The online application identifies high risk cases although it is up to individual bodies to decide which, and how many, matches to investigate. Our review of the system noted that, as at February 2020, HIE had reviewed all 495 of its matches and investigated 261 (53%) including all high-risk matches.

27. We are satisfied that HIE was pro-active in reviewing matches and conducting the appropriate investigations. No frauds were found but investigations identified 24 matches where duplicate payments totalling £39,104 had been made to suppliers. More than half of this amount (£17,801) had been identified and recovered prior to the NFI exercise. A further £10,256 has been recovered and HIE continues to pursue recovery of the remaining amounts.

28. HIE's internal audit section made three recommendations to improve internal controls to prevent duplicate payments as a result of the 2018/19 NFI exercise. There is limited flexibility to change internal controls due to how the ledger system is set up but, where possible, duplicate invoice number checking has been introduced. Reports on the results of the NFI exercise were submitted to the Risk and Assurance Committee in August and December 2019.

Follow up of 2018/19 Management Report action plan

Openness and transparency

29. Last year we reported significant delays in publishing minutes of Board and Risk and Assurance Committee (RAC) meetings on HIE's website. We also reported that registers of interests had not been published for the three new Board members and that registers of interest for the remaining Board members had not been updated since April 2018.

30. In response, officers advised that they had set a target for minutes of future Board and RAC meetings to be published within 10 working days of their approval. As part of our interim audit, we reviewed HIE's website in April 2020 and noted that the latest Board minutes available were for the September 2019 meeting and the latest RAC minutes were for the meeting in December 2018. We concluded that more work is required to ensure that Board and RAC minutes are published within the target timescale.

31. We also noted that registers of interest for all Board members were published on HIE's website and up to date to April 2020, in line with the bi-annual review. We have concluded that this action has been fully implemented.

Appendix

Action Plan



No.	Issue/risk	Management Response	Responsible officer and revised target date
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1	<p>Openness and transparency</p> <p>Last year we reported that there were significant delays in publishing minutes of Board and RAC meetings on HIE's website. In response, officers set a target for minutes of future Board and RAC meetings to be published within 10 working days of approval.</p> <p>In April 2020 we reviewed HIE's website and noted that the latest available Board and RAC minutes were for the September 2019 and December 2018 meetings respectively.</p> <p>Risk: gaps in the information on HIE's website affects transparency and may also affect stakeholders' perception of HIE's commitment to openness and transparency.</p>	<p>Following the review by Audit Scotland last year, a significant amount of work was undertaken to ensure the backlog of unpublished minutes dating from 2016 were published. HIE are currently undertaking an exercise to ensure outstanding Board and RAC minutes for 2019/20 are brought up to date. We aim to have these published by end of July 2020 at the latest. For the future, HIE will aim to publish minutes within 20 working days of approval.</p>	<p>Responsible officer: Head of Executive Support</p> <p>Revised date: 31 July 2020</p> <p>2018/19 target dates: Board Minutes – 31 May 2019 RAC minutes – 31 July 2019</p>
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