

# Highlands and Islands Enterprise

Annual Audit Plan 2020/21



 AUDIT SCOTLAND

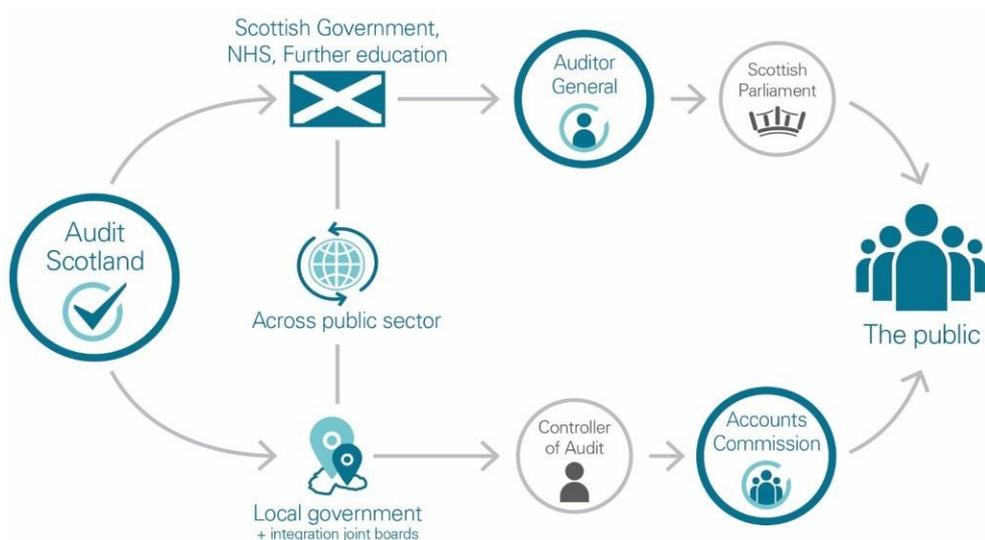
Prepared for Highlands and Islands Enterprise

March 2021

## 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.

# Contents

---

Risks and planned work	4
Audit scope and timing	10

---

# Risks and planned work

---

## Introduction

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 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.

## Impact of COVID-19

3. The public health crisis caused by the coronavirus disease 2019 (COVID-19) pandemic has had a profound effect on every aspect of society. Public services have been affected significantly, requiring immediate changes to the way they are provided. The impact on public finances has been unprecedented, which has necessitated both the Scottish and UK governments providing substantial additional funding for public services as well as support for individuals, businesses, and the economy. It is likely that further financial measures will be needed and that the effects will be felt well into the future.

4. Audit Scotland continues to manage the impacts of COVID-19 on the audit process. We expect the 2020/21 audit to be challenging as our resources are under pressure from the extended 2019/20 reporting timescales and the current lockdown restrictions. The well-being of audit teams and the delivery of high-quality audits remain paramount. Our aim is to maintain a pragmatic and flexible approach to enable change at short notice as new issues emerge, or current risks change in significance. Where this impacts on annual audits, changes to this annual audit plan may be necessary.

## Adding value

5. 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 intend to help HIE promote improved standards of governance, better management and decision-making and more effective use of resources.

## Audit risks

6. 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 2020/21 audit of HIE. We have categorised these risks into financial statements audit risks and wider dimension audit risks. The key audit risks, which require specific audit testing, are detailed in [Exhibit 1](#).

## Exhibit 1

### 2020/21 significant audit risks

 Audit Risk	Source of assurance	Planned audit work
<b>Financial statements risks</b>		
<p><b>1 Risk of material misstatement due to fraud caused by the management override of controls</b></p> <p>International Auditing Standards require that audits are planned to consider the risk of material misstatement in the financial statements caused by fraud, which is presumed to be a significant risk in any audit. This includes the risk of fraud due to the management override of controls.</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>
<p><b>2 Risk of material misstatement caused by fraud in income recognition</b></p> <p>As set out in ISA (UK) 240, there is a presumed risk of fraud in the recognition of income.</p> <p>HIE and its group received £15 million of income from sources other than the Scottish Government in 2019/20 and expect a similar amount in 2020/21. It has also received additional income to fund COVID-19 relief initiatives.</p> <p>The extent and nature of this income means that there is a risk that the financial statements will be misstated due to fraud in income recognition.</p>	<p>Effective budgetary control arrangements are in place including monitoring of income and anti-fraud arrangements.</p> <p>The risk of fraud was considered for each COVID fund and appropriate mitigations put in place.</p>	<p>Review of HIE's anti-fraud arrangements.</p> <p>Walkthrough and testing of controls over receivables focusing on any changes in approach resulting from COVID-19.</p> <p>Detailed testing of revenue transactions focusing on the areas of greatest audit risk including property income, EU income and COVID-19 related funding.</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.</p> <p>Last year, 26% of HIE's expenditure was on grants to third parties. Since March 2020 it has been distributing COVID-19 grants to help support businesses impacted by the pandemic.</p> <p>The extent and nature of this expenditure means that there is a risk that the financial statements will be misstated due to fraud in expenditure.</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 of HIE's anti-fraud arrangements.</p> <p>Walkthrough and testing of controls over payables systems focusing on any changes in approach resulting from COVID-19.</p> <p>Document and test the controls over the authorisation and payment of COVID-19 grants.</p> <p>Substantive testing of grant expenditure with reliance on internal audit's work on significant transactions and COVID-19 payments.</p>

 Audit Risk	Source of assurance	Planned audit work
		<p>Substantive cut-off testing of expenditure to ensure that it has been recognised in the correct financial year.</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 (£31m), pension liabilities (£41m), and investments (£2m). There is also a degree of estimation and judgement in accrued expenditure (£5m), accrued income (£2m) and provisions (£14m).</p> <p>This subjectivity represents an increased risk of material 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 fields.</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 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>Review the work of an expert for management’s professional valuers (non-current assets and pension liabilities),</p> <p>Review management’s assessment of the appropriateness of the assumptions used in the valuation of these assets and liabilities.</p> <p>Review management’s processes for valuing investments.</p> <p>Substantive testing of year-end balances including provisions and related disclosures.</p>
<p><b>5 Changes to FReM requirements for narrative reporting</b></p> <p>Last year we noted that there was scope to improve the performance report. This year’s Government Financial Reporting Manual (FReM) includes a new chapter (Chapter 3) on lessons learned from the Government Financial Reporting Review, examples of good practice and guidance on improving narrative reporting. Chapters 5 (performance report) and 6 (accountability report) of the FReM have also been revised.</p> <p>There is a risk that the 2020/21 annual report and accounts do not reflect the revised FReM requirements.</p>	<p>We have noted these changes in our update to the Risk and Assurance Committee.</p> <p>The team preparing the annual report and accounts will be meeting to discuss the changes to ensure we are all familiar with the new requirements.</p> <p>HIE’s financial accountant will be responsible for ensuring we comply with the new FReM requirements.</p>	<p>Review of the performance and accountability reports against requirements set out in the 2020/21 FReM.</p> <p>Review of completed disclosure checklist and investigation of any areas of non-compliance.</p>

**Wider dimension risks****6 Governance and transparency - impact of COVID-19**

Since March 2020, HIE has had a key role in Scotland's response to COVID-19, supporting jobs and businesses through the distribution of COVID-19 grants. Decision-making in a fast-moving environment presents a challenge for HIE and other public bodies. These include maintaining good governance and controls while making decisions quickly, adapting performance measures and ensuring that anti-fraud arrangements remain robust at a time when the risk of fraud is increased.

There is a risk that appropriate governance and oversight has not been applied.

Governance arrangements were reviewed, in year, in response to the COVID-19 impact on the regional economy and the organisation's operating arrangements.

Any changes to internal control arrangements were informed by risk awareness, the needs of the region and our businesses and communities.

Risk appetite statements were updated, and approaches were tailored for each fund in consultation with the Scottish Government.

Award decisions are made public by either HIE or its partners.

We will review:

- the extent and nature of COVID-19 grant funding provided to HIE and distributed by HIE to businesses
- governance and accountability arrangements for distributing COVID-19 funding, including scrutiny by the Board and steps taken to minimise fraud and error
- key financial controls over COVID-19-related income and expenditure
- performance targets for the efficiency and effectiveness of COVID-19 funding
- internal audit's work on COVID-19 response and COVID-19 grants.

**7 Financial sustainability**

HIE will have a key role to play in the recovery and renewal of the Highlands and Islands economy post-COVID whilst continuing to face significant financial pressures in areas where there is uncertainty about the timing and amount of potential expenditure (e.g. repair of Cairngorm funicular railway, and the Spaceports development).

There is a risk that HIE is unable to deliver all of its existing financial commitments and achieve its performance targets whilst supporting the recovery and renewal of the local economy.

HIE is actively involved in national recovery planning discussions.

An operating plan is being prepared which identifies strategic priorities which will support the region's recovery and delivery of new areas of opportunity.

A 5-year financial planning outlook has been prepared to support the operating plan and updated approaches to resource prioritisation and interventions are being put in place.

Regular financial reporting to the Leadership Team and the Board with corrective action to be taken as appropriate.

Close liaison with Sponsor Team in Scottish Government regarding financial forecasts and assumptions around in-year funding.

Review financial plans for recovery and renewal post-COVID.

Review monitoring reports and the financial position at the year-end including performance against resource limits set by the Scottish Government.

Ongoing discussions with HIE about its financial position.

 Audit Risk	Source of assurance	Planned audit work
<p><b>8 Governance and transparency – cyber security</b></p> <p>Organisations are increasingly threatened by cyber-attacks as evidenced by recent incidents affecting public bodies. This risk is heightened due to the impact of COVID-19 such as remote-working.</p> <p>HIE has a shared Enterprise Information Services (EIS) IT arrangement with Skills Development Scotland (SDS) and Scottish Enterprise (SE). HIE is currently working to strengthen its cyber security arrangements including implementing improvement actions identified during the recent cyber security maturity assessment.</p> <p>There is a risk that a cyber-attack could disrupt HIE’s systems, including its key financial systems.</p>	<p>Attendance at EIS’ Security Council.</p> <p>Cyber Essentials is now in place and Cyber Essentials Plus assessment will be completed as soon as access to offices becomes available.</p> <p>Regular reports are made to the Risk and Assurance Committee and an annual assurance statement is provided by EIS.</p> <p>Action plan in place to address the improvement actions included in the cyber maturity assessment.</p> <p>Audit programme in place for EIS agreed by partners.</p>	<p>Assess progress towards improving cyber security including achieving Cyber Essentials Plus accreditation</p> <p>Consider disclosure of cyber security risk in the governance statement within the annual report and accounts.</p>

Source: Audit Scotland

## Reporting arrangements

**7.** Audit reporting is the visible output for the annual audit. All annual audit plans and other outputs are detailed in [Exhibit 2](#), with indicative target dates for completion (see references to timetable in paragraph 23). These 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).

**8.** 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 officers to confirm factual accuracy.

**9.** 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 the Accountable Officer and Auditor General for Scotland with an annual report on the audit containing observations and recommendations on significant matters which have arisen during the audit.

**10.** The unique and continuing challenges presented by COVID-19 mean that we are starting the current year’s audits later than in previous years and that audits are taking longer to complete. As a result, the timescales set out below reflect available audit resources and prioritisation decisions. We will endeavour to meet the timescales set out below but recognise that this may not be possible due to uncertainty resulting from the COVID-19 pandemic.

## Exhibit 2

### 2020/21 audit outputs

Audit Output	Target date	Committee Date
Annual Audit Plan	26 February 2021	2 March 2021
Management Report	25 May 2021	1 June 2021
Annual Audit Report and proposed Independent Auditor's Report	8 September 2021	15 September 2021
Independent Auditor's Report (signed)	15 September 2021	N/A

### Audit fee

**11.** The agreed audit fee for the 2020/21 audit of HIE is £141,390 (2019/20 agreed fee: £137,970). 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 a complete unaudited annual report and accounts and working papers package on 14 June 2021.

**12.** Where our audit cannot proceed as planned through, for example, late receipt of the unaudited annual report and accounts, 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 out with our planned audit activity.

### Responsibilities

#### Risk and Assurance Committee and Accountable Officer

**13.** 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.

**14.** 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

**15.** 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.

**16.** 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

**17.** 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.

**18.** We will give an opinion on whether the financial statements:

- whether the financial statements give a true and fair view of the financial position of HIE and its group as at 31 March 2021 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

**19.** 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 audited part of 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.

**20.** 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

**21.** 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.

**22.** We calculate materiality at different levels as described below. The calculated materiality values for Highlands and Islands Enterprise are set out in [Exhibit 3](#).



### Exhibit 3

#### Materiality values

Materiality	HIE	Group
<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 gross expenditure for the year ended 31 March 2020 based on the 2019/20 audited accounts.	£1.015 million	£1.025 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.	£405,000	£410,000
<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	£50,000

Source: Audit Scotland

### Timetable

**23.** To support the efficient use of resources it is critical that a timetable is agreed with us for the preparation and audit of the annual report and accounts. [Exhibit 4](#) sets out the agreed timetable which takes account of submission requirements. We will endeavour to meet the timescales set out below but recognise that this may not be possible due to uncertainty resulting from the COVID-19 pandemic.

### Exhibit 4

#### Annual accounts timetable

 Key stage	 Date
Latest submission date of unaudited annual report and accounts with complete working papers package	14 June 2021
Latest date for final clearance meeting with Director of Finance and Corporate Services	3 September 2021
Agreement of audited unsigned annual report and accounts and issue of draft Annual Audit Report to those charged with governance	8 September 2021
Independent auditor's report signed	15 September 2021

## Internal audit

**24.** Internal audit is provided by HIE's in-house internal audit team supported by a contract with Azets 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.

**25.** ISA (UK) 610 requires an assessment on whether the work of the internal audit function can be used for the purposes of external audit. As part of our planning process we carried out an annual assessment of the internal audit function and concluded that internal audit's work can be used for external audit purposes.

### Using the work of internal audit

**26.** International Auditing Standards require internal and external auditors to work closely together to make best use of available audit resources. 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 substantive testing of significant transactions.

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

- financial and budgetary risks
- certificates of assurance and governance statement.

**28.** We will also consider the internal audit arrangements for EIS which are jointly procured by HIE and its partners (Skills Development Scotland and Scottish Enterprise).

## Audit dimensions

**29.** 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 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 carry out work and conclude on:

- 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 there are arrangements in place to demonstrate the affordability and effectiveness of funding and investment decisions.

### Financial management

**31.** 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:

- whether arrangements are in place to ensure systems of internal control are operating effectively
- the effectiveness of budgetary control systems in communicating accurate and timely financial performance can be demonstrated
- whether there are appropriate and effective arrangements in place for the prevention and detection of fraud and corruption.

**32.** In prior years we have recommended that HIE review whether its finance team had sufficient financial skills and capacity to meet its needs. Following review by the Director of Finance and Corporate Services in November 2019, two additional staff were recruited for the finance team. We will consider the impact that these new posts have had on the finance team's financial skills and capacity as part of our 2020/21 audit.

### Governance and transparency

**33.** Governance and transparency is 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:

- 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)
- 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.

### Value for money

**34.** Value for money refers to using resources effectively and continually improving services. We will review, conclude, and report on whether HIE can demonstrate how it continues to monitor and report on progress towards meeting the Enterprise and Skills Strategic Plan's objectives.

### Best Value

**35.** HIE's Accountable Officer has a duty to ensure arrangements are in place to secure best value. We will review and report on these arrangements as part of our 2020/21 audit.

## Independence and objectivity

**36.** Auditors appointed by the 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.

**37.** 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

**38.** 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.

**39.** 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) has been commissioned to carry out external quality reviews.

**40.** 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 2020/21

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)

For the latest news, reports and updates, follow us on:



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)