



# Crown Estate Scotland\*

**External Audit Report for the financial year ended 31 March 2020**

Annual Report to the Board and the Auditor General for Scotland

Final Report September 2020

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\* Following the enactment of the Scottish Crown Estate Act 2019, Crown Estate Scotland became the formal legal name of Crown Estate Scotland (Interim Management).



# Financial statements audit at a glance



We received a complete set of financial statements and annual report in accordance with our planned audit timetable. Due to the travel restrictions and social distancing measures introduced by the government in response to the Covid-19 pandemic we have delivered the audit remotely.



We have fulfilled our responsibilities per International Standards on Auditing (ISAs) (UK) and the Audit Scotland Code of Audit Practice throughout our work. This final report to the Board and the Auditor General concludes our work.



Significant audit risks are: management override of controls; the risk of fraud in revenue recognition; and, the valuation of investment property. An additional significant audit risk was identified in relation to Covid-19, reported to the Audit and Risk committee in June 2020, which caused significant disruption to all public sector entities in the later half of March 2020.

An audit  
underpinned by  
quality and adding  
value to you



The Annual Report including the Overview and Performance analysis is in line with our understanding of Crown Estate Scotland and in particular the vision and strategic priorities. The Governance Statement, outlines the governance framework. The Remuneration and Staff report has been prepared in accordance with the Public Finance and Accountability (Scotland) Act 2000, and directions thereunder. The disclosures in the Remuneration and Staff report are consistent with underlying payroll records.



We have issued an unmodified audit opinion on the annual report and accounts. Our audit opinion includes an emphasis of matter paragraph in relation to the material uncertainty over the valuation of investment property arising as a result of Covid and the forecast economic downturn.



We updated our audit materiality to reflect your 2019/20 draft financial statements. Materiality is set at **£9.338 million**. This represented 2% of net assets in line with our audit plan. We set a specific materiality of **£330,000**, being approximately 1.5% of gross revenue based on the 2019/20 unaudited accounts. This materiality was applied to the Revenue Account. We applied a lower materiality threshold on review of the Remuneration and Staff report to ensure that remuneration has been disclosed within appropriate bandings (being **£2,500**).

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### **Adding value through our external audit work**

First and foremost our objective is to ensure we deliver a quality external audit which fully complies with International Standards on Auditing (ISAs) UK and the Audit Scotland Code of Practice (2016).

Through this Annual Audit Report Report we seek to provide insight and commentary over certain aspects of Crown Estate Scotland's (CES) arrangements, sharing relevant practices with the Audit and Risk Committee and Management.

We have continued to build on our working relationship with management and our understanding of CES as an organisation. During 2019/20, our audit was delivered remotely. We utilised our own valuations expert to support our scrutiny and challenge over investment property valuations in year. While this supported our audit work over the valuations, it resulted in delays in completing our audit procedures. We have held positive discussions with Management around our audit approach for 2020/21, including earlier testing and consideration of valuations work to maximise the efficiency and effectiveness of our audit processes.

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# Contents

<b>Section</b>	<b>Page</b>
Introduction	5
Responding to significant risks	7
Other key elements of the financial statements	12
Narrative elements of your annual accounts	15
Wider scope audit – Key messages	16
Wider scope – significant risks	17
Wider scope commentary	20
 <b>Appendices:</b>	
Audit adjustments	28
Investment property valuations	29
Action plan and recommendation	30
Follow up of 2018/19 recommendations	31
Audit fees and independence	32
Fraud arrangements	33
Communication of audit matters	34

# Introduction

## Reporting

This report is a summary of our findings from our external audit work for the financial year ended 31 March 2020.

Our work has been undertaken in accordance with International Standards on Auditing (ISAs) (UK) and the Audit Scotland Code of Audit Practice 2016.

Our report is addressed to the Board of Crown Estate Scotland (CES). In addition, in accordance with our reporting responsibilities the report is jointly addressed to the Auditor General for Scotland.

Once the accounts are laid in parliament this report will be made publicly available on the Audit Scotland website ([www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk))

We would like to thank CES management and the finance team for an effective year end audit process and all their support and assistance throughout the year.

## Structure of this report

In accordance with the Audit Scotland Code of Practice 2016, in addition to our core financial statements audit we provide conclusions on the four dimensions of wider-scope public audit (diagram below).

Our report is structured as follows:

- Financial statements audit including conclusions on significant risks and key elements of the financial statements – Section 1
- Wider scope dimensions including key messages and conclusions on significant wider scope risks – Section 2



## Our Opinion

For the financial year ended 31 March 2020 we have issued an **unmodified audit opinion**:

- True and fair view of the financial statements
- Regularity – expenditure has been incurred in accordance with the purpose of Crown Estate Scotland.
- Other prescribed matters (which include the audited information in the remuneration report)

## Emphasis of matter – Investment property valuation

We draw attention to CES's annual report and accounts Note 3b to the financial statements, which describes the significant judgements, key assumptions and estimates in relation to property valuations.

Management engaged experts to value their investment property portfolio. The expert's valuation included a 'material valuation uncertainty' as per VPS 3 and VPGA 10 of the RICS Red Book Global.

Consequently, less certainty and a higher degree of caution should be attached to management's valuation than would normally be the case. Our opinion is not modified in respect of this matter.

## Materiality

Our audit approach was set out in our audit plan presented to the Audit and Risk Committee on 20th February 2020. We updated our audit materiality to reflect your 2019/20 draft financial statements. Materiality is set at £9.338 million. This represents 2% of net assets in line with our audit plan.

We set a specific materiality of £330,000, being approximately 1.5% of gross revenue based on 2019/20 unaudited accounts. This materiality was applied to the Revenue Account reflecting the lower value of transactions through this primary financial statement.

Since issuing the draft audit plan, we recognised an additional risk in relation to the impact of Covid-19 pandemic on CES and the risk of material misstatement to the financial statements. This was reported to the Audit and Risk Committee in June 2020..

We applied a lower materiality threshold for Directors Remuneration disclosures within the Remuneration and Staff Report to ensure that remuneration has been disclosed within the appropriate bandings (being £2,500)

We report to management any difference identified over £250,000 (Trivial capped at £250,000 by Audit Scotland).

## The audit process

In accordance with our annual external audit plan our audit work commenced our year end audit work on 1 June 2020. We received a good complete set of financial statements and supporting documentation. Following internal review and finalisation of performance and remuneration information an updated draft set of accounts was received at the end of June 2020.

Due to the travel restrictions and social distancing measures introduced by the government in response to the Covid-19 pandemic, we have delivered the audit remotely.

There were no material misstatements to the primary financial statements. There were a small number of disclosure adjustments in respect of the draft financial statements including the disclosure of related party transactions. A full listing of adjusted misstatements is detailed in Appendix 1. We do not consider these to be material to the financial statements.

## Internal control environment

During the year we sought to understand CES' overall control environment (design) as related to the financial statements. In particular, we have:

- Considered procedures and controls around related parties, journal entries and other key entity level controls.
- Performed walkthrough procedures of key financial processes including income and expenditure recognition, journal postings, payroll, investment property and valuations. This includes processes in place for ensuring information reported by management agents is appropriately recorded including underlying transactions.

Our work over controls is limited to our ISA requirements in understanding an entities control environment. Our audit is not controls based and we do not place reliance on controls operating effectively as our audit is fully substantive in nature.

Our audit testing followed transactions to invoice and bank payment and we therefore did not rely on the design or operating effectiveness of controls in place at Management agents. We identified no material weaknesses or areas of concern from this work which would have caused us to alter the planned approach as documented in our plan.

# Responding to significant risks

Risk area	Identified audit risks at planning
<b>Risk of fraud in revenue recognition: Revenue Account</b>	<p>Set out in ISA 240, there is a presumed risk that revenue may be misstated due to improper recognition of revenue. CES generates revenue through a range of activities using the investments held. This is through rent and royalties as well as materials produce (forestry). CES are a net contributor to the Scottish Government. As part of the annual budget setting process CES agree the percentage of net revenue surplus that can be transferred to the capital account each year with the remaining surplus being an annual revenue contribution to the Scottish Government. Contributions are made during the year but the final payment is due once the financial statements audit is complete and outturn position finalised. There is therefore an incentive for fraudulent recognition of revenue to deliver outturn targets. Financial targets are based on the financial year end (contributions to Scottish Government) and consequently there is greatest focus on outturn position. We therefore consider the risk to be most prevalent in revenue transactions and balances recognised around the year end as these would be the transactions most susceptible to incorrect recognition through fraud.</p> <p>CES also generates revenue through capital receipts from the sale of assets. However, these are recognised through the Capital Fund for the purposes of capital reinvestment and therefore not directly impacting on the revenue outturn position. We therefore do not attach the significant risk to these revenue streams.</p>
Work completed	
<ul style="list-style-type: none"><li>• Walkthroughs of the controls and procedures over revenue income (rent and royalties and produce)</li><li>• Substantive testing (at an elevated risk level) of income recognised pre and post year end to identify if there is any potential misstatement</li><li>• Substantive testing (at an elevated risk level) of income recognised in the final month of the year to identify if this has been potentially overstated (focus on final month given revenue recognised in monthly performance information from management agents).</li><li>• Review and sample testing of debtors to gain comfort around the recoverability of balances at the year end.</li></ul>	
Our conclusion	
<p>Based on our testing we conclude:</p> <ul style="list-style-type: none"><li>• We did not identify any exceptions in our cut-off testing of year end income.</li><li>• We did not identify in our testing any potential fraudulent reporting of income.</li><li>• We did not identify any material misstatements arising from our testing of income transactions around the year end.</li></ul>	

## Risk area

### Management override of controls

## Identified audit risks at planning

As set out in ISA 240 there is a presumed risk that management override of controls is present in all entities. This risk area includes the potential for management to use their judgement to influence the financial statements as well as the potential to override the organisation's controls for specific transactions.

We consider those key judgements that are most susceptible to significant audit risk of management override are those over expenditure recognition. These are areas where management has the potential to influence the financial statement through estimate and judgement.

## Work completed

- Considered the design of controls in place over key accounting estimates and judgements through performance of walkthrough procedures.
- Reviewed accounting estimates for management bias / indication of fraud that could result in material misstatement. This included review of estimates as at 31 March 2020 and retrospective review of those estimates as at 31 March 2019.
- Journals testing including:
  - Assessment of the design of controls in place over journal entries, including journal preparation, authorisation and processing onto the financial ledger;
  - Risk assessment of the journals population to identify large or unusual journal entries, such as those that are not incurred in the normal course of business, or those entries that may be indicative of fraud or error that could result in material misstatement. We tested these journals to ensure they are appropriate and suitably recorded in the financial ledger;
  - Target testing of transactions around the financial year end, reviewing large journals and those which appear unusual to understand the rationale for the transaction.

## Our conclusion

Based on our testing we conclude:

- There was no evidence of management override in our testing of controls.
- Our risk based testing of journals did not identify any indication of fraud or management override.
- Through our audit testing we have also considered accounting estimates over the valuation of investment properties
- We did not identify any unusual or significant transactions throughout the financial year or during the financial close period which were out with the ordinary operations of CES.

Risk area	Identified audit risks at planning
<b>Valuation of Investment properties</b>	<p>As at 31 March 2030, CES's financial statements reported £426 million of investment property. This includes a range of assets including commercial and residential properties, land leased for energy production, forestry and seabed. In accordance with International Financial Reporting Standard 40: <i>Investment Property</i> (IFRS 40), the assets are held at fair value in the financial statements. CES engage with valuation specialists to determine an appropriate valuation for these. Investment properties are valued based on a number of key assumptions including an estimate of future rental income. There is a risk that the valuation either under or overstates the asset values reflected in the accounts.</p>
<b>Work completed</b>	
<p><b>Management expert</b></p> <ul style="list-style-type: none"> <li>We considered the independence and objectivity of the appointed valuer and consider their competence and experience as a suitable management experts.</li> <li>We confirmed the completeness of underlying information provided by CES or used by the valuer in arriving at the valuation of investment property.</li> <li>We agree the valuation report provided by the valuers to the underlying accounting entries made by CES.</li> </ul> <p><i>Valuation</i></p> <ul style="list-style-type: none"> <li>We challenged the suitability of the valuation methodology to ensure consistent with IAS 40 (See further details of investment portfolio in Appendix 2).</li> <li>We engaged our own auditor valuation expert to challenge the reasonableness of the methodology applied by CES in arriving at the valuation of investment property.</li> <li>We tested the completeness and accuracy of underlying data used by the external valuers to arrive at the valuation.</li> <li>We challenged the appropriateness of the assumptions adopted by the valuer, including where relevant, reference to rental agreements in place and assumptions around forecast rental revenue.</li> <li>We challenged managements assessment of impairment risk including consideration of indicators of impairment in the valuation of investment property held including the impact of Covid-19 and wider economic environment. For relevant investments, we considered the level of post year end revenue received on tenancy / lease arrangements to assess potential indication of impairment.</li> </ul>	
<b>Our conclusion</b>	
<p>In accordance with IAS 40: <i>Investment properties</i>, the property portfolio was valued on 31 March 2020. Given the diverse range of properties held, the work was conducted by independent accredited external valuers with a recognised relevant professional qualification and with recent experience in the locations and categories of the investment property being valued.</p> <p>Based on our testing we can conclude:</p> <ul style="list-style-type: none"> <li>Investment property has been valued in accordance with IAS 40: <i>Investment Property</i>. We have agreed CES's Investment property valuations to the independent valuations.</li> <li>The assumptions adopted by Management and the valuers are reasonable and we have not identified any issues with the completeness or accuracy of the underlying data used in the valuation.</li> <li>While we have not identified any concerns over the work performed by the valuers, we have identified opportunities to enhance the valuation instructions issued to independent valuers to provide greater clarity over the scope of coverage of the valuation being applied. In addition, it is important that CES continue to ensure there is appropriate arrangements to ensure the independence and objectivity of appointed valuers as the organisation matures and relationships with valuers evolve (see Action Plan point 1).</li> </ul> <p>The carrying value of investment property increased from £385.8 million in 2018/19 to £426.1 million in 2019/20. The increase was primarily through the increase in offshore wind renewables reflecting the progress made with offshore wind scheme developments. As schemes reach significant milestones, this reduces risk of return in investment and subsequent valuation of investment. The overall investment portfolio also reflected market conditions as at 31 March 2020 and where applicable, the valuer has incorporated allowances for the impact of Covid-19 on investment valuations.</p>	

## Our conclusion (continued)

The valuations are driven by a range of assumptions including future income generation or yield. With the impact of Covid-19, relevant valuations have been amended to reflect the estimated impact of Covid-19 in future revenue streams, particularly across retail and urban portfolio.

### Covid-19

The Royal Institute of Chartered Surveyors (RICS) have issued a valuation practice note regarding material uncertainties in valuations as a result of impacts to the market caused by Covid-19. The RICS Red Book defines material uncertainty as 'where the degree of uncertainty in a valuation falls outside any parameters that might normally be expected and accepted. CES' valuers have reported their valuation advice on the basis of 'material valuation uncertainty' as per VPS 3 and VPGA 10 of the RICS Red Book Global Standards effective from 31 January 2020. Due to the impact of Covid-19 there is less underlying transactions and data to support valuations. Consequently, less certainty, and a higher degree of caution, should be attached to our valuation advice than would normally be the case. CES has disclosed the material uncertainty within note 3 of the accounts. We have included an emphasis of matter paragraph within our independent audit opinion to highlight the matter to the reader of the accounts. Our audit opinion is not modified in respect of this matter.

In appendix 2 we have summarised the valuation of the investment property portfolio as at 31 March 2020. While we have agreed the carrying value of investment property to independent valuation reports, we highlight the sensitivity the carrying value of investment properties have to movements in underlying value.

Overall we are satisfied investment property has been valued in accordance with IAS 40: *Investment properties* and that the assumptions adopted by Management and the valuers are reasonable and we have not identified any issues with the completeness or accuracy of the underlying data used in the valuation.

## Risk area

### Covid-19

## Identified audit risks at planning

The global outbreak of the Covid-19 virus pandemic has led to unprecedented uncertainty for all organisations, requiring urgent business continuity arrangements to be implemented. We expected current circumstances would have an impact on the production and audit of the financial statements for the year ended 31 March 2020, including and not limited to;

- Remote working arrangements and redeployment of staff to critical front line duties may impact on the quality and timing of the production of the financial statements, and restrict the evidence we can obtain through physical observation;
- Volatility of financial and property markets will increase the uncertainty of assumptions applied by management to investment property valuation and receivable recovery estimates, and the reliability of evidence we can obtain to corroborate management estimates;
- Financial uncertainty will require management to reconsider financial forecasts supporting their going concern assessment and whether material uncertainties for a period of at least 12 months from the anticipated date of approval of the audited financial statements have arisen; and
- Disclosures within the financial statements will require significant revision to reflect the unprecedented situation and its impact on the preparation of the financial statements as at 31 March 2020 in accordance with IAS1, particularly in relation to material uncertainties.

We therefore identified the global outbreak of the Covid-19 virus as a significant risk, which was one of the most significant assessed risks of material misstatement.

## Work completed

- We reviewed the impact of the Covid-19 pandemic on the valuation of investment properties.
- We liaised with Audit Scotland and other providers under the Audit Scotland contract framework, and take into account wider guidance emerging related to audit quality (for example FRC guidance) and specific sector guidance
- We evaluated the adequacy of the disclosures in the financial statements in light of the Covid-19 pandemic.
- We evaluated whether sufficient audit evidence using alternative approaches can be obtained for the purposes of our audit whilst working remotely
- We evaluated whether sufficient audit evidence can be obtained to corroborate significant management estimates such as investment property valuation and recovery of receivable balances
- We evaluated management's assumptions that underpin the revised financial forecasts and the impact on management's going concern assessment
- We discussed with management any potential implications for our audit report if we have been unable to obtain sufficient audit evidence

## Our conclusion

Based on our testing we conclude:

- Covid-19 and remote working did not restrict CES's ability to prepare the financial statements or restrict the audit evidence required to complete the audit. We did not consider that any revision were required to our materiality calculations.
- Management's assumptions underpinning financial forecasts and the going concern assessment have adequately considered the potential impact of Covid-19.
- We have not identified any significant impact on CES' debtor recovery.
- The impact of COVID-19 has resulted in a material uncertainty surrounding the valuation of investment property (see Valuation of Investment Property significant risk)
- Management have adequately assessed the impact of Covid-19 on the organisations governance arrangements.

# Other key elements of the financial statements

Accounting area	Summary of policy	Comments	Assessment
<b>Revenue recognition</b>	Revenue recognition	<p>For 2019/20 CES reported net revenue of £22 million. Revenue is recorded net of VAT and comprises rental income, royalties and other income. Rental income is recognised over the term of the lease agreement, amended to reflect any rent free period. Royalty income is received in return for the extraction of minerals including aggregates from the land and seabed.</p> <p>We are satisfied that the revenue recognition is in accordance with the FReM and International Financial Reporting Standard 15: <i>Revenue from Contracts with Customers</i>.</p>	 Green
<b>Judgements and estimates</b>	Property valuations held at fair value  Operating lease	<p>Investment properties are those properties which are held either to earn rental income or for capital appreciation or both. Investment properties are valued by independent valuers and held at fair value at the reporting date. Any surplus or deficit arising on the revaluation of investment properties is recognised in the Consolidated Capital Account. As at 31 March 2020, CES held investment properties of £426.1 million.</p> <p>As detailed under Significant Financial Statement Risks: Valuation of Investment Properties (earlier in the report), CES has reported a 'material uncertainty' in the valuation of investment property.</p> <p>CES currently disclose significant estimates and judgements within Note 3 to the financial statements. During our audit we challenged a number of the significant estimates and judgements included within the draft financial statements and Management have reviewed and reflected on these to ensure those disclosed cover estimates and judgements that involve material disclosure. Management will continue to reflect upon the key estimates and judgements in future years' accounts.</p>	 Green

## Assessment

-  Marginal accounting policy which could potentially be open to challenge
-  Accounting policy appropriate but scope for improved disclosure
-  Accounting policy appropriate and disclosures sufficient

Accounting area	Summary of policy	Comments	Assessment
<b>Other critical policies</b>	Impact of the Crown Estate Act 1961 and departure from the FRoM	<p>The Accounts are prepared under ministerial direction issued under the Crown Estate Act 1961 ('the 1961 Act'). To meet the requirements of the 1961 Act, the movements in comprehensive income are analysed between revenue and capital accounts. The capital account includes profits or losses arising from the sale of investment properties; the realisation of revaluation gains; the income arising on the grant of operating leases over land in exchange for a premium; the charge from revenue for salary costs; and, the transfers between the capital and revenue account as required by statutory provisions and capital transfer agreements.</p> <p>Due to the provisions of the 1961 Act, CES deviates from the requirements of IFRS in respect of lease premiums. Where a lease premium is received in respect of an operating lease of less than 30 years, the 1961 Act (chapter 55) requires income is taken direct to the revenue account. This is in conflict with the treatment required under IFRS 15 which requires such income to be spread over the lease term. We are satisfied that this is in accordance with the 1961 Act and the Accounts Direction.</p> <p>Accounting policies have been applied consistently to the previous year. No new International Financial Reporting Standards (IFRS) have been adopted in the year as the adoption of IFRS 16 for public bodies has been delayed by a year as a result of the Covid-19 pandemic.</p>	 Green

### Assessment

- Marginal accounting policy which could potentially be open to challenge
- Accounting policy appropriate but scope for improved disclosure
- Accounting policy appropriate and disclosures sufficient

## Going concern

CES budget for 2020/21 forecasts comprehensive revenue account profit of £8.8 million, distributable to the Scottish government Consolidated Fund. Management have recognised the increased risk around the potential impact of Covid-19 on revenue during the year. Management continue to monitor financial performance and cash balances closely to continue to evaluate the potential impact of Covid-19. As at June 2020, revenue for the year remained in line with budget with operating expenditure slightly below forecast. CES are in discussion with Scottish Government around proposed payment schedule for cash transfer of amounts distributable to the Consolidated Fund allowing a degree of flexibility in managing cash flows.

From consideration of CES going concern assessment, financial plans, and 2020/21 financial performance to date, we are satisfied that CES continues to represent a going concern.

## Fraud and irregularity

CES has arrangements in place to help prevent, detect, and mitigate the risk of fraud or irregularity. While we consider these to be reasonable, no arrangements can fully prevent against the risk of fraud, theft, or irregularity. We are not aware of any material frauds at CES during the year and have confirmed this with management.

## Valuation instructions

CES commission independent valuations of its Investment Property from a number of different valuers. As part of our audit testing over investment property valuations we considered the scope of the valuers' work including terms of appointment and valuation instructions provided by Management. From our review we found that instructions did not always explicitly state the accounting and valuation standards to be applied (RICS guidance) and explicit details around the assets to be valued. While our subsequent testing of the valuations, including challenge to the valuers, did not find any issues with the valuation standards and guidance applied, it is important that CES ensure that instructions to valuers provide a clear framework in which they expect valuations to be conducted to avoid potential non-compliance with applicable guidance or accounting standards. We understand that CES is in the process of retendering valuation services. We recommend that CES use this as an opportunity to review the instructions issued to valuers to ensure these are kept up to date, reflect the latest RICS guidance and clearly define assets to be valued.

*Action plan point - 1*

# Narrative elements of your annual accounts

In accordance with our responsibilities we have reviewed your narrative aspects of the Annual Report and Accounts. We have considered the consistency of this narrative with our understanding and the financial statements and have set out our observations below. We have also audited the required information in the remuneration report (marked audited) and have no matters we wish to bring to your attention.

## Performance analysis

Provides a summary of key performance activity across the year

The report summarises the key priorities, achievements and developments during the year. The performance analysis highlights activities undertaken by CES to deliver the strategic priorities

## Overall Observations

CES recognises the important that the Annual Report and accounts have in communicating the organisation's performance during the year. The "front end" of the Annual Report and Accounts, tells the story of CES as an organisation including strategic priorities, risks and achievements made during the year. The Performance summary provides a high level overview of performance during the year and the Annual Report includes case studies to highlight key activities.

## Performance report and accountability report (including remuneration and governance)

## Remuneration and staff report

The Remuneration and Staff report has been prepared in accordance with the Public Finance and Accountability (Scotland) Act 2000, and directions thereunder. During our audit we identified a small disclosure adjustment in relation to Non-Executive remuneration bandings and these have been reflected in the amended accounts.

The disclosures in the Remuneration and Staff report are consistent with underlying payroll records.

## Governance statement

The governance statement is included within the Accountability Report. The report outlines the governance framework in place at CES.

We raised a disclosure adjustment to amend the Statement of Accountable Officer's Responsibilities to meet the requirements of the FReM. We are satisfied this has been reflected in the updated accounts. The Governance statement reflects assurances provided in year by both Management those charged with governance and the report recognises that CES did not have an independent internal auditor appointed for the whole year.

# Wider scope key messages



CES generated a net profit (comprehensive revenue account) of £12 million which contributes to the Scottish Government Consolidated Fund. This exceeded the initial budgeted target of £9 million. The performance ahead of budget in the year was primarily due to increased revenue generation through aquaculture revenue and Marine energy and infrastructure. In particular revenue generated through offshore production. CES reported net capital profit of £40.5 million. This was primarily driven by the increase in the value of marine (offshore energy and infrastructure). The value of offshore energy and infrastructure is driven by progress in the development of offshore schemes and has been the key area of growth within CES' investment portfolio.



The Corporate Plan 2020-2023 was published in April 2020 following a public consultation process. The Corporate Plan outlines the Board's strategic priorities over the next three years incorporating principles of Scottish Crown Estate Act 2019. CES are refining the content of the performance dashboard and reporting arrangements. This is to align reporting with the new Corporate Plan 2020-23. The reporting arrangements aim to align performance indicators and targeted outcomes with the new plan with information provided in quarterly reporting to the board. While we recognise that the financial reporting framework continues to be refined, a key challenge is ensuring that the Board continue to receive regular timely indicators of performance throughout the year to support effective decision making. The nature of some of this information (tenant satisfaction etc) can often be only available once a year so it is important that CES consider the inclusion of wider indicators of performance that may provide the Board with more timely data on performance and potential areas where further action is required



CES has developed its Investment Strategy to help deliver the organisation's purpose to generate lasting value for Scotland. CES aims to manage and increase the capital release and to re-invest in a broader range of assets with capital investment over the 3-year period of the Corporate Plan at approximately £70 million delivering a 2% per annum increase in assets held. These objectives are balanced with ensuring CES investment supports some of the wider requirements of the Scottish Crown Estate Act 2019 legislation, including wider value to the Scotland beyond financial returns as well as enabling other bodies to take on management responsibilities over assets. With the economic uncertainty due to the impact of Covid-19 and the potential implications of UK withdrawal from the EU uncertain, CES will face significant challenges delivering the outcomes targeted in the strategy. The coming years will represent a critical period in which CES will need to balance investing and managing in an estate that represents financially sustainable investments while supporting the organisation's wider corporate objectives.

# Wider scope – significant risks

Within our annual audit plan we identified two significant wider scope risks in relation to financial sustainability and delivering performance targets in a backdrop of financial challenges. As part of our audit we have reviewed the arrangements in place at CES around these wider scope risks.

## Wider Scope Significant Risk: Financial management identified in our Annual Audit Plan

CES has a relatively small finance team, given the size and breadth of investment activity. Recognising this, during 2019/20 CES appointed a Financial Controller, a new position within the organisation, to enhance the financial management capacity and capability. However, the Director of Finance left the organisation in December 2019. While CES are in the process of recruiting for the position, this has left the body without a Director of Finance for two months during the current financial year. As CES is establishing its new Corporate Plan and underlying strategic Investment Strategy, it is important that there is effective financial leadership and governance in place to support the development of the plan as well as wider financial management arrangements.

### Audit response to significant wider scope risk

We will consider the arrangements established by CES in supporting the financial management and governance arrangements, including the interim arrangements established in the absence of a Finance Director. We will consider the extent to which interim arrangements established during the year ensure appropriate financial management as well as continuing to provide strategic financial support to inform the development of the corporate plan and investment strategy.

## Grant Thornton's conclusion

*CES recognised the risk of having key person dependencies, particularly in finance roles, in operating with a relatively small workforce. During 2019/20 CES looked to address the risk through the creation of a new Financial Controller post and the appointment of the Director of Finance and Business Services and also the extension of the fixed term Finance Manager post. These posts not only strengthen the Finance function but provide greater opportunities to undertake succession planning and career development within the wider team. These new arrangements should provide the organisation with sufficient financial capacity and capability.*

***CES recognise that financial capacity and capability will be critical as the organisation looks to implement its Investment Strategy in a challenging economic environment dealing with the implications that Covid-19 may have on its investment portfolio.***

## Wider Scope Significant Risk: Governance and transparency identified in our Annual Audit Plan

As a relatively new organisation, CES has been establishing governance arrangements. However, while CES manage over £400 million of assets, there is a relatively small management team to support this. While new governance arrangements continue to develop and embed, there are a number of areas that continue to require focus. In particular: the transparency around scrutiny and governance arrangements (public meetings); scrutiny arrangements; and the absence of an independent internal audit function during 2019/20. As a consequence there is a risk that CES does not have arrangements to comply with the Scottish Public Finance Manual (SPFM) or support effective and transparent governance.

### Audit response to significant wider scope risk

We will review the arrangements in place at CES to support compliance with the SPFM. In particular, we will consider the extent to which CES focus on compliance with good practice with SPFM and plans in place to address any identified gaps. In relation to the absence of an Internal Audit function during the year, we will assess the arrangements put in place during the year to provide assurance to the Audit and Risk Committee (and Board) around the systems of internal control.

## Grant Thornton's conclusion

*During 2019/20 CES undertook a review of pay terms and conditions. Following consultation with staff and union representatives, CES implemented revised pay and conditions more aligned to those outlined within the SPFM. In particular the removal of performance related pay awards or bonuses.*

*An Assurance Framework has been developed in the year by the Chief Executive and Governance Manager for implementation as part of the 2019/20 annual report and accounts process. The framework is based on the relevant provisions in the SPFM. This has included each Director providing evidenced assurance to the Chief Executive that appropriate management is in place in their business areas.*

*During 2019/20 CES did not have an independent internal Audit service. This represents a departure from the requirements of the SPFM and limits the level of independent assurance the Audit & Risk Committee have over the governance, risk management and internal control arrangements. Management recognised this and during the year there were a number of senior management in-house internal control improvement reviews undertaken covering contract management; health and safety; procurement; assurance framework and finance. In addition, CES commissioned an external review of its IT infrastructure.*

*CES has appointed RSM to provide this function for CES from 2020/21 which should ensure independent assurance going forward in accordance with the SPFM. Whilst there has been a lack of Internal Audit coverage in 2019/20, it is anticipated that the appointment of RSM will support the development of the assurance framework to ensure that the organisation has the appropriate internal controls, governance and risk management in place to deliver its objectives in 2020/21 and beyond. To ensure future provision of Internal Audit services, CES should ensure that it has plans in place to ensure that future internal audit tenders are conducted with sufficient timeliness to ensure a smooth transition from one provider to the next.*

***During 2019/20 CES did not have an independent internal audit function. This represents a departure from the requirements of the SPFM and limits the level of independent assurance to the Audit & Risk Committee. The appointment of RSM to provide the service from 2020/21, should support the organisation monitor and scrutinise the effectiveness of its internal control, risk management and governance arrangements.***

## Wider Scope Significant Risk: Value for money

The Scottish Crown Estate Act (2019) introduces a number of requirements for CES. In particular, there is a greater focus on delivering value beyond financial return and enabling other bodies to take on management responsibilities of the assets of the Crown. CES is undertaking a consultation on a new Corporate Plan to reflect the legislative and strategic priorities of the organisation. It is essential that CES's performance management framework is developed to enable performance to be assessed against the Corporate Plan, including financial and non-financial benefits.

### Audit response to significant wider scope risk

We will assess the extent to which CES has developed clear and concise performance measures to provide an objective assessment of performance against the organisation's corporate priorities. We will consider the extent to which the performance framework is aligned to the corporate priorities.

### Grant Thornton's conclusion

*CES's Corporate Plan has a range of KPIs and targets covering the organisation's five strategic objectives. A performance management framework is in place to enable these performance targets to delegate the annual Business Plan to individual staff members' performance objectives. Progress is tracked throughout each financial year through quarterly reports to the Board, monthly leadership and team meetings, as well as quarterly individual performance reviews. CES are refining the content of the performance dashboard and reporting arrangements. This is to align reporting with the new Corporate Plan 2020-23. The reporting arrangements aim to align performance indicators and targeted outcomes with the new strategy with information provided in quarterly reporting to the Board. The reporting framework continues to be refined and Management recognise that a key challenge is ensuring that the Board continue to receive regular timely indicators of performance throughout the year to support effective decision making.*

***CES has continued to develop its performance reporting arrangements to the Board to support effective scrutiny and decision making.***

## Financial performance – Revenue account and capital account

CES generated a net profit (comprehensive revenue account) of £12 million (2018/19: £11.4 million) and capital account profit of £40.5 million (2018/19: £82.2 million). The net profit of £12 million to be contributed to the Scottish Government Consolidated Fund exceeded the agreed target of £9 million. This is consistent with previous year's performance where 2017/18 and 2018/19 also generated more funds for the public purse than originally estimated. Half of the total £12 million surplus was paid to the Scottish Government during the 2019/20 financial year. CES and the Scottish Government have agreed an interim deferral on further 2019/20 payments until the COVID-19 situation becomes clearer.

CES net profit of £12 million for 2019/20 was predominantly generated through increased revenue generation in year. Marine (energy and Infrastructure) income (£7.7 million) and Marine (aquaculture income) (£5.5 million). 2019/20 saw an increase in offshore production and subsequently revenue from cable and pipeline activities increased in year increasing marine revenue. In addition there was a higher than anticipated level of finfish production in the year increasing aquaculture revenue from £4 million in 2018/19 to £5.5 million in 2019/20.

The net capital profit reported within the Capital account, predominantly represents the net revaluation gains on investments. During 2019/20, CES reported net capital profit of £40.5 million. This was primarily driven by the increase in the value of marine (offshore energy and infrastructure). The value of offshore energy and infrastructure is driven by progress in the development of offshore schemes. As schemes reached key milestones this increases the value of the investment. While 2019/20 saw a significant growth in the valuation of these investment properties, this was not as significant as the corresponding growth in 2018/19. This is expected as the value depends on the progress of each individual scheme.

## Investment strategy and the impact of Covid-19

The Corporate Plan 2020-2023 was published in April 2020 following a public consultation process. The plan sets out CES' strategic framework and how they will invest in property, natural resources, and people to deliver lasting value for Scotland.

The Corporate Plan incorporates the Investment Strategy which deliver the organisation's purpose to generate lasting value for Scotland. CES operates within a unique legislative framework and approach to capital accounting where capital is routinely released from the estate and reinvested to increase the value of the estate. In its strategy, CES aims to manage and increase the capital release and to re-invest in a broader range of assets. CES has targeted total committed capital investment over the 3-year period of the corporate plan at approximately £70 million. This is based on raising £40 million to add to existing reserves through marine and coastal agreements, and sales of rural and built environment assets. The Investment strategy is incorporated into the Corporate Plan. The Strategy forecasts that the underlying investment portfolio will increase by approximately 2% per annum up to 2023.

The Corporate Plan also incorporates the wider responsibilities of CES as outlined within the Scottish Crown Estate Act 2019. CES wider objectives extend beyond aiming to generate financial return on investments including supporting the wider Scottish economy, promoting new sustainable ways of using natural resources to produce energy, food and other products as well as enabling other bodies to take on management responsibilities for assets of the Crown..

## Financial planning

The Business Plan acknowledges that 2020/21 will see the team delivering on the strategic objectives of the organisation but also contribute to the economic recovery work being developed by the Scottish Government. In response to the crisis, Finance have been working closely with the Government to monitor the ongoing effects of COVID-19 and are coordinating actions with government aid packages. This was particularly important to the shellfish sector who have been significantly impacted by the pandemic.

CES are also preparing cautious budgets to accommodate payment deferrals and defaults and have agreed to suspend net revenue payments to the Government during the crisis. Central to this is close engagement with tenants to understand their hardships and ascertain how best CES can support them to manage the impacts on their businesses and how to deal with rent payments in line with advice from the Scottish Government. It is crucial that CES maintains this close liaison with tenants, the sponsor team and the Government sectoral policy leads to allow CES to continue to model the potential impacts on revenue from affected sectors and potential expenditure to be contributed to relief activity within their budget for 2020/21.

## Financial planning and impact of covid-19

Whilst during 2019/20 CES outperformed budget, over the coming years the organisation faces important decisions in balancing strategic investment decisions that support medium term financial performance while contributing to wider Corporate objectives of supporting wider economic growth and enabling other parties to manage and benefit from the wider assets of the Crown. This is against a backdrop of significant economic uncertainty due to the impact of Covid-19. CES project over the next three years that the organisation will continue to grow its revenue profit and contributions to the Scottish government (public purse). However, management recognise that this continues to be an area of focus in the coming years.

Revenue forecast	2020/21	2021/22	2022/23
Gross Revenue (£ million)	21.6	24.6	28.4
Total Costs (£ million)	(11.0)	(12.1)	(12.9)
Statutory Transfers (£ million)	(2.0)	(2.0)	(2.2)
Revenue (contribution to Scottish Government) (£ million)	8.6	10.6	13.3

As the impact of the Covid-19 continues to impact on the wider economy, CES continue to review the impact this has on the organisation. A key area of risk to CES is in relation to lease defaults leading to loss of revenue, reduced capital valuation and increased liabilities. CES analysis indicate that the sectors most impacted by government lockdown and social distancing restrictions are the shellfish (reliant on export and hospitality sectors); tourism (CES impact is mainly marine and rural tourism) and retail(primary impact is George Street).

While there remains significant uncertainty around the medium to longer term impact of COVID-19, to date CES 2020/21 remains in line with budget. Management have agreed a revised payment schedule with the Scottish Government for contribution payments which is aimed at providing CES with sufficient cash reserves to manage potential payment delays or breaches from tenants over the coming months.

A key challenge will be ensuring investment decisions support CES medium to longer term financial sustainability while supporting the deliver of the wider corporate objectives including supporting the wider Scottish economy and acting as an enabler for other organisations to manage the assets of the Crown. Management recognise this requires careful, informed, decision making and the development of the investment framework will be key. Management have arrangements in place for monitoring the impact of Covid-19 on revenue streams and the underlying cost base. This includes detailed information on income collection and are informed of underlying performance through managing agents. Looking forward, CES should ensure that as the investment framework is embedded to ensure that there continues to be robust scrutiny and challenge of investment opportunities to ensure continued focus on the strategic priorities while potentially significant operational challenges including the impact of Covid-19.

# Governance and transparency

## Covid-19 governance arrangements

In March 2020, CES implemented remote working arrangements to continue to operate whilst adhering to the travel and social distancing measures introduced by the government following the outbreak of Covid-19. CES were well prepared to operate remote working arrangements with online access already set up. There has therefore been limited impact on the operation of internal processes and controls. Governance arrangements have continued to function, with Board and committee meetings being held remotely.



## Governance Arrangements

CES is required to comply with the Framework Document published in April 2020 in line with the new duties and provisions in force under the Scottish Crown Estate Act 2019. To support this, CES continued to embed its governance arrangements and in May 2020 CES published a Code of Conduct for Board Members which details the expectations, responsibilities, and behaviours of all appointments to the Board.

The CES board met six times during 2019/20 reviewing CES's operational and financial performance compared to plan, business strategy and risk management as well as high level review and scrutiny of health and safety issues. We found the level of reporting to the Board and the Audit and Risk Committee and Investment Committee to be appropriate with key performance reports transparent and aligned to the Board strategic priorities.

The CES Board is supported through the Investment Committee, which focuses on key strategic investment and planning decisions, and the Audit & Risk Committee. The Board has also established a short-term advisory committee, the People Committee, to provide support and guidance to the Board and Chief Executive in the delivery of people related objectives in the Corporate and Business Plans. The Committee will oversee the delivery of the People Strategy, the skills and capacity review, the progress of the office move project and other people-related activities including staff learning and development, change management, and performance management. This will further enhance the current governance arrangements particularly with significant projects ongoing such as the office relocation which will have a staff-wide impact in 2020/21.

There is an increased focus on how public money is used and what is achieved. This includes the extent to which CES keeps pace with public expectations and good practices in this area. It was highlighted in the 2018/19 annual audit report that minutes of Board meetings were being published however Board papers and committee minutes were not. Management have sought to address this during 2019/20, with Board papers being published online. Openness and transparency of corporate publications and Board minutes and papers play an important role in CES demonstrating how it uses its resources including how it delivers community benefit from assets held.



## Internal audit

During 2019/20 CES did not have an Internal Audit service in place. Management recognised this and during the year there were a number of senior management in-house internal control improvement reviews undertaken covering contract management; health and safety; procurement; assurance framework and finance. In addition, CES commissioned an external review of its IT infrastructure.

RSM have been appointed as Internal Auditors from 2020/21. The Internal Audit Strategy for 2020-23 was presented to the Audit and Risk Committee in April 2020 and was created based on an audit needs assessment, review of previous internal audit coverage, CES risk register, and discussions with the Chief Executive, Director of Finance and Business Services, and other senior staff. The plan also recognises the current COVID-19 situation and its impact on the organisation's risk profile.

Whilst there has been a lack of Internal Audit coverage in 2019/20, it is anticipated that the appointment of RSM will support the development of the assurance framework to ensure that the organisation has the appropriate internal controls, governance and risk management in place to deliver its objectives in 2020/21 and beyond.

To ensure future provision of Internal Audit services, CES should ensure that it has plans in place to ensure that future internal audit tenders are conducted with sufficient timeliness to ensure a smooth transition from one provider to the next.



## Risk Management

CES has developed its Risk Management Framework which is overseen by the Audit & Risk Committee. Their approach to risk management is in alignment with the SPFM and is designed to ensure that risks faced by the organisation are managed effectively and in accordance with the principles of good corporate governance. A revised Risk Management Policy was presented to and approved by the Board at its May 2020 meeting.

In line with the Risk Management Policy, the strategic risk register is monitored by the Executive Team monthly, the Audit and Risk Committee quarterly, and the Board throughout the year. The risk register has been subject to scrutiny and development to ensure that the risks identified, and mitigating actions are appropriate and reflect the strategic risks facing the service. The current strategic risk register has been updated to include the significant risks associated with COVID-19, recognising the potential financial and operational impacts of the pandemic on the organisation.



## Office relocation

In its Business Plan for 2020/21, CES includes the costs associated with relocation from the current Bell's Brae office. The plan recognises that this move, in conjunction with additional investment in IT capabilities, are important strands of work designed to contribute to the long-term sustainability and productivity of CES.



In addition to the People Committee, CES has established a New Office Project Board and Staff Advisory Group to ensure adequate governance is in place. To support oversight of these groups, a project plan, action tracker and project risk register have been established. The strategic risk register has also been updated to include the risk that office accommodation is not sourced and developed in time to replace the current accommodation. As at April 2020, this was rated as high risk, requiring further mitigation and close monitoring through the defined governance structure.

The Director of Finance & Business Services has engaged with the sponsor team and Scottish Government's property division in relation to the preferred option for the new office and approval had now been received from Scottish Ministers for CES to pursue this option. As at May 2020, next steps were to finalise heads of terms with the landlord of the preferred option and make a formal offer, followed by consultations with staff and the trade union, PCS. It has been confirmed by the current property owner that the redevelopment of the Bells Brae office is to proceed without delay, and therefore CES are required to vacate the property by the end of 2020. It is important that the planned steps are undertaken at pace to ensure a timely transition into the new offices prior to the end of the calendar year, although we recognise the significant challenges that the COVID-19 situation presents.

# Value for money

## Performance

CES's Corporate Plan has a range of KPIs and targets covering the organisation's five strategic objectives. A performance management framework is in place to enable these performance targets to delegate the annual Business Plan to individual staff members' performance objectives. Progress is tracked throughout each financial year through quarterly reports to the Board, monthly leadership and team meetings, as well as quarterly individual performance reviews. It was highlighted at the Board meeting in May 2020 that the content of the performance dashboard and future reporting would take a different format in line with new Corporate Plan 2020-2023.

Performance reporting to the March 2020 Board showed that CES were making good progress over a number the KPIs with 38 out of 45 assigned a green RAG status (minimum 80% complete/on track), 6 amber (partially delivered/at risk/delayed) and only 1 red (target missed/abandoned). The latter was in relation to the assessment of long-term options for Rhu Marina. As part of business planning for 2020/21 CES will be assessing options for the marina.

## Procurement

The Scottish Crown Estate Act 2019 provides for CES' assets to be managed in a way which delivers greater value beyond financial return and enables other bodies to take on management responsibilities. All public sector organisations procuring goods and services must ensure they obtain value for money. As a Contracting Authority, CES is now required to comply with the Procurement Reform (Scotland) Act 2014, the Public Contracts (Scotland) Regulations 2015, and the Procurement (Scotland) Regulations 2016. Contracting Authorities must also have regard to any statutory guidance published by Scottish Ministers. As such, CES now has an obligation to prepare and publish a Procurement Strategy and to ensure that policies and procedures are in line with the regulatory requirements.

In order to support this, a Procurement Manager was appointed in April 2020 to lead on the development of the Strategy. An Interim Procurement Strategy and Policy have been reviewed by the Executive Team and will undergo consultation with internal and external stakeholders before publishing in September 2020. It is important that CES embed the requirements of the Procurement Policy and Strategy internally but also gain assurance that managing agents who undertake procurement activity on CES' behalf are also acting in line with the revised requirements.

There is also an obligation for Contracting Authorities to prepare, publish and maintain a Contract Register and a Record of Planned Regulated Procurements. CES does not currently publish this information but work to develop this has commenced. All current contracts in place with CES are being reviewed to retrieve the required information for publication within the Contract Register. Recurring contracts and other planned procurements to support specific projects will be identified and will inform the Record of Planned Regulated Procurements. It is intended that the Contract Register and Record of Planned Regulated Procurements will be presented for consideration by the Board before publishing in September 2020.

The proposed Strategy and Policy along with publication of a Contract Register and Forward Procurement Plan will ensure there is greater transparency of CES procurement operations. It is expected that this should also generate wider interest in CES procurement opportunities and subsequent increased competition and better value for money going forward into 2020/21.



## Contract Management

During 2019/20, CES identified an internal control failure in relation to contract management where payments to a supplier had exceeded the agreed cap and had also been made post contract expiry. As a result, a wider review of contract management was initiated across CES to provide assurance that all contracts were in order throughout the organisation. Such assurance was provided from the Director of Marine and Director of Property. However, within Finance and Business Services, there were two types of transactional activity identified that did not follow the requirements of a Scottish Public Sector Contracting Authority. One was in relation to contracts being extended on a rolling basis and the other in relation to contract costs exceeding the fixed price without an extension applied or the contract re-procured. Whilst there was no associated material impact on CES' finances, budgets, or value for money, persistent weaknesses in procurement processes could result in failure to achieve value for money in future procurement activity. It is understood that both situations would be captured under the revised Procurement Strategy and Policy, and with the introduction of the contract register in line with the new obligations of CES as a Contracting Authority.

## External Managing Agents

CES has approximately 50 staff working across different parts of Scotland but also contract teams of managing agents to provide specialist knowledge and support in rural and coastal areas. This model gives the organisation flexibility and access to a wide range of expertise whilst helping to manage costs.

CES is in the process of retendering their coastal and rural managing agents' contracts to ensure best value for money and access to the specialist expertise required to deliver their 2020-23 Corporate Plan. CES recognise the importance of the role managing agents have in enabling the organisation both operationally as well as strategically in delivering its objectives. The tendering process has been overseen by the Board and CES has commissioned external support to review and scrutinise the tender process including independent internal audit review. It is critical for CES that the tender processes is robust to support CES appoint managing agents that will support the organisation deliver its strategic objectives.



# Appendices

- Audit adjustments
- Investment property valuations
- Action plan and recommendations
- Follow up of prior year recommendations
- Audit fees and independence
- Fraud arrangements
- Communication of audit matters

# Audit adjustments

## Uncorrected and corrected misstatements

We are pleased to report that there were no material corrected or uncorrected misstatements to the financial statements arising during our audit.

During the course of our audit work we identified a number of disclosure adjustments required to the draft financial statements. This includes adjustments identified by Management during the audit process. The following are those adjustments that have been adjusted for in the updated draft accounts

Item	Description	Adjusted
1	Cash flow statement	Minor disclosure changes to cash flow statement (note all immaterial)
2	Remuneration report	Update to reflect disclosures around remuneration bandings to ensure consistent with total remuneration paid in year
3	Related party disclosures	Related party disclosures updated to reflect the requirements of the FReM.
4	Significant judgements	Disclosure around material judgements and estimation uncertainty in accordance with IAS 1. This included inclusion around material uncertainty in relation to investment property. The current disclosure includes investment property and operating leases. While we do not consider operating leases to be a significant estimate or judgement. Management will continue to review this as part of ongoing review of judgements.
5	Governance Statement	Statement of Accountable Officer responsibility updated to reflect FReM disclosure guidance

There were a number of minor adjustments to the Annual report and accounts made during the course of the audit which we do not consider significant.

## Disclosure misstatements – uncorrected

We did not identify any material uncorrected disclosure misstatements in the financial statements. We have highlighted to management opportunities for enhancing disclosures in the Annual Report and accounts but do not consider them to be material to the financial statements. Management will look to incorporate these into financial statement preparation process in 2020/21.

# Investment properties valuation

The valuations are driven by a range of assumptions including future income generation or yield. The impact of Covid-19 has reduced the level of transactions and data points to support the valuation thus reducing the certainty that could be applied to the valuation. While we are satisfied that the valuations included in the accounts are consistent with the valuation reports and based on available information as at 31 March 2020 we highlight the sensitivity of the valuations to movements in value below.

Class of property	Fair value 31 March 2020 £m	Valuation technique	Sensitivity of valuation to +/- 10% movement	Audit satisfied of the suitability of the work of the expert	Valuation supported by adequate documentation including valuation report
<b>Rural and Coastal portfolio:</b>					
Agricultural	98.9	Comparable / Investment	+/- £9.89 million	✓	✓
Coastal	35.3	Investment	+/- £3.53 million	✓	✓
Forestry	19.8	Comparable	+/- £1.98 million	✓	✓
Minerals	2.3	Investment	+/- £0.2 million	✓	✓
<b>Marine portfolio:</b>					
Renewables – Offshore Wind	205.3	Investment / Discounted Cash Flow	+/- £20.5 million	✓	✓
Renewables – Wave & Tidal	0.2	Discounted Cash Flow	+/- £0 million	✓	✓
Cables & Pipelines	24.9	Investment	+/- £2.49 million	✓	✓
Aquaculture	26.5	Investment	+/- £2.65 million	✓	✓
<b>Urban portfolio:</b>					
Offices & retail	13.0	Investment	+/- £1.3 million	✓	✓
<b>Total all portfolios at valuation</b>	<b>426.2</b>				

# Action plan and recommendations

We have set out below, based on our audit work undertaken in 2019/20, the two significant recommendations arising from our audit work.

## Recommendation

## Agreed management response

### 1. Valuation instructions

As part of our audit testing over investment property valuations we considered the scope of the valuers' work including terms of appointment and valuation instructions provided by Management. From our review we found that instructions did not always explicitly state the accounting and valuation standards to be applied (RICS guidance) and explicit details around the assets to be valued. While our subsequent testing of the valuations, including challenge to the valuers, did not find any issues with the valuation standards and guidance applied, it is important that CES ensure that instructions to valuers provide a clear framework in which they expect valuations to be conducted to avoid potential non-compliance with applicable guidance or accounting standards. We understand that CES is in the process of retendering valuation services. We recommend that CES use this as an opportunity to review the instructions issued to valuers to ensure these are kept up to date, reflect the latest RICS guidance and clearly define assets to be valued.

**Management response:** A number of contracts for annual portfolio valuations are currently being re-procured. Each Invitation to Tender document explicitly states the accounting and valuation standards to be applied and details around the assets to be valued. For the remaining valuations the Letters of Instruction (provided prior to the valuation being undertaken) will contain this information.

**Action owner:** Director of Finance and Business Services

**Timescale for implementation:** March 2021

### 2. Financial planning and the impact of Covid-19

Looking forward, CES should ensure that as the investment framework is embedded to ensure that there continues to be robust scrutiny and challenge of investment opportunities to ensure continued focus on the strategic priorities while potentially significant operational challenges including the impact of Covid-19.

**Management response:** The CES management response is in four parts.

**Budget structures** - Key steps to revising our budget structures are well advanced, this includes further strengthening cost allocation to roles and asset types, and building the capital pipeline in advance of budget sign-off.

**Portfolio management** - CES is introducing a portfolio management approach across the asset-base. This will use a variety of indicators of performance, both financial and non financial and will include the application of the Value Project asset profile measures.

**Capital decision making** - CES is introducing enhanced capital decision making processes and have established programme and project management for significant capital activities.

**Reporting** - Financial reporting will be added to through the use of portfolio reporting, and it is intended the annual report and accounts section 2 will be developed to provide further financial information on the four roles the assets and the Investment Strategy Portfolio.

**Action owner:** Chief Executive

**Timescale for implementation:** March 2021

# Follow up of 2018/19 recommendations

We set out below our follow up of our 2018/19 recommendations and these are reflected below for information.

## Recommendation

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### Financial capacity and capability

During 2019 CES has sought to recruit a financial controller to provide additional capacity and capability to the finance team. An appointment has been made, the candidate is due to join the organisation in Autumn 2019. The pressure facing the finance team was evident in some of the findings in the Internal Audit report around enhancing controls and sign-offs as well as during our external audit where maternity leave and staff turnover left the finance team reduced to support the audit process.

With the development of the investment strategy and subsequent investment activity, it will become increasingly important that there is sufficient capacity and capability within the finance team to support the organisation both in terms of financial operational management as well as supporting

### Initial management response:

Staff resourcing is an issue that has been raised and discussed with the Audit and Risk Committee and the Chief Executive, initially towards the end of 2018, and regularly since. It is acknowledged as an area of risk and recruitment has been a priority in order to improve resilience and to alleviate substantial pressure and workload of the existing team members. It has proved challenging to recruit suitable candidates swiftly. Future growth plans include additional roles to resource investment activities. It will be important to consolidate existing work activities and embed new staff in advance of that.

### Follow up: CLOSED

While CES recognise that a relatively small workforce creates a risk of key person dependencies particularly in specialist areas such as finance, the organisation has increased the capacity of the finance team during the year. This will be critical in supporting CES deliver its investment strategy and wider Corporate Plan.

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## Corporate publications

CES publish a range of key corporate documentation including business plans. Board meetings are held around the country to encourage wider engagement and participation with key partners across Scotland. Minutes of Board meetings are published online. However, committee minutes as well as board papers are not. In addition, we found that board papers are not uploaded onto the public website in a timely manner with the latest version online being March 2018.

While we recognise that sensitive information may be withheld, we recommend that to ensure openness and transparency in decision making and the use of public funds, CES look to publish Board minutes in a more timely manner.

### Initial management response

All agendas papers & minutes for the meetings to March 2019 have now been uploaded to our website. The agenda, papers & minutes for the meeting held in May 2019 will not be uploaded until after the next meeting when the Board have approved the draft minutes of the March meeting.

### Follow up: CLOSED

The CES website is now more regularly updated to reflect the Agenda, meetings and papers of relevant governance meetings.

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# Audit fees and independence

## External Audit Fee

Service	Fees £
External Auditor Remuneration	29,515
Pooled costs	6,240
Contribution to Audit Scotland costs	1,490
Contribution to Performance Audit and Best Value	-
<b>2019/20 Fee</b>	<b>37,245</b>

## Fees for other services

Service	Fees £
We confirm that for 2019/20 we did not receive any fees for non-audit services	Nil

## Independence and ethics

- We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention.
- We have complied with the Financial Reporting Council's Ethical Standards and therefore we confirm that we are independent and are able to express an objective opinion on the financial statements.
- We confirm that we have implemented policies and procedures to meet the requirements of the Financial Reporting Council's Ethical Standards.
- We are required by auditing and ethical standards to communicate any relationships that may affect the independence and objectivity of the audit team.
- We can confirm no independence concerns have been identified.

## Client service

We take our client service seriously and continuously seek your feedback on our external audit service. Should you feel our service falls short of expected standards please contact Joanne Brown, Head of Public Sector Assurance Scotland in the first instance who oversees our portfolio of Audit Scotland work ([joanne.e.brown@uk.gt.com](mailto:joanne.e.brown@uk.gt.com)). Alternatively, should you wish to raise your concerns further please contact Jon Roberts, Partner and Head of Assurance, 30 Finsbury Square, London, EC2A 1AG. If your feedback relates to audit quality and we have not successfully resolved your concerns, your concerns should be reported to Elaine Boyd, Assistant Director, Audit Scotland Quality and Appointments in accordance with the Audit Scotland audit quality complaints process.

# Fraud arrangements

The term fraud refers to intentional acts of one or more individuals amongst management, those charged with governance, employees or third parties involving the use of deception that result in a material misstatement of the financial statements. In assessing risks, the audit team is alert to the possibility of fraud at Crown Estate Scotland.

As part of our audit work we are responsible for:

- identifying and assessing the risks of material misstatement of the financial statements due to fraud in particular in relations to management override of controls.
- Leading a discussion with those charged of governance (for Crown Estate Scotland this is assumed to be the Audit and Risk Committee) on their view of fraud. Typically we do this when presenting our audit plan and in the form of management and those charged with governance questionnaires.
- designing and implementing appropriate audit testing to gain assurance over our assessed risks of fraud
- responding appropriately to any fraud or suspected fraud identified during the audit.

As auditors we obtain reasonable but not absolute assurance the financial statements as a whole are free from material misstatement, whether due to fraud or error.

We will obtain annual representation from management regarding managements assessment of fraud risk, including internal controls, and any known or suspected fraud or misstatement.

## Anti-Money Laundering Arrangements

As required under the Money Laundering, Terrorist Financing and Transfer of Funds Regulations 2017 there is an obligation on the Auditor General (as set out in the planning guidance) to inform the National Crime Agency if she knows or suspects that any person has engaged in money laundering or terrorist financing. Should we be informed of any instances of money laundering at Crown Estate Scotland we will report to the Auditor General as required by Audit Scotland.

The primary responsibility for the prevention and detection of fraud rests with management and those charged with governance including establishing and maintaining internal controls over the reliability of financial reporting effectiveness and efficiency of operations and compliance with applicable laws and regulations.

It is Crown Estate Scotland responsibility to establish arrangements to prevent and detect fraud and other irregularity. This includes:

- developing, promoting and monitoring compliance with standing orders and financial instructions
- developing and implementing strategies to prevent and detect fraud and other irregularity
- receiving and investigating alleged breaches of proper standards of financial conduct or fraud and irregularity.

Throughout the audit we work with Crown Estate Scotland to review specific areas of fraud risk, including the operation of key financial controls. We also examine the policies in place, strategies, standing orders and financial instructions to ensure that they provide a strong framework of internal control.

All suspected frauds and/or irregularities over £5,000 are reported to Audit Scotland by us as your auditors on a quarterly basis.

# Communication of audit matters

International Standards on Auditing (UK) (ISA) 260, as well as other ISAs, prescribe matters which we are required to communicate with those charged with governance, and which we set out in the table below.

Our communication plan	Audit Plan	Audit Findings
Respective responsibilities of auditor and management/those charged with governance	•	
Overview of the planned scope and timing of the audit, including planning assessment of audit risks and wider scope risks	•	
Confirmation of independence and objectivity <b>Confirmed, no matters to report.</b>	•	•
A statement that we have complied with relevant ethical requirements regarding independence. Relationships and other matters which might be thought to bear on independence. Details of non-audit work performed by Grant Thornton UK LLP and network firms, together with fees charged. Details of safeguards applied to threats to independence	•	•
Significant matters in relation to going concern <b>None identified although commentary included on financial sustainability alongside going concern commentary.</b>	•	•
Views about the qualitative aspects of Crown Estate Scotland's accounting and financial reporting practices, including accounting policies, accounting estimates and financial statement disclosures <b>Included within the report.</b>		•
Significant findings from the audit <b>Included within the report</b>		•
Significant matters and issues arising during the audit and written representations that have been sought <b>Included in this report and letter of representation obtained at date of signing.</b>		•
Significant difficulties encountered during the audit <b>None identified.</b>		•
Significant deficiencies in internal control identified during the audit <b>None identified.</b>		•
Significant matters arising in connection with related parties <b>None identified.</b>		•
Identification or suspicion of fraud involving management and/or which results in material misstatement of the financial statements. <b>None identified.</b>		•
Non-compliance with laws and regulations <b>None identified</b>		•
Unadjusted misstatements and material disclosure omissions <b>Reported in Appendix 1 of this report.</b>		•
Expected modifications to the auditor's report, or emphasis of matter. <b>Emphasis of matter included in the audit report, due to valuation of investment property.</b>		•



The contents of this report relate only to the matters which have come to our attention, which we believe need to be reported to you during our audit. It is not a comprehensive record of all the relevant matters, which may be subject to change, and in particular we cannot be held responsible to you for reporting all of the risks which may affect the entity or all weaknesses in your internal controls.

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