

# Highlands and Islands Enterprise

2019/20 Annual Audit Report



 AUDIT SCOTLAND

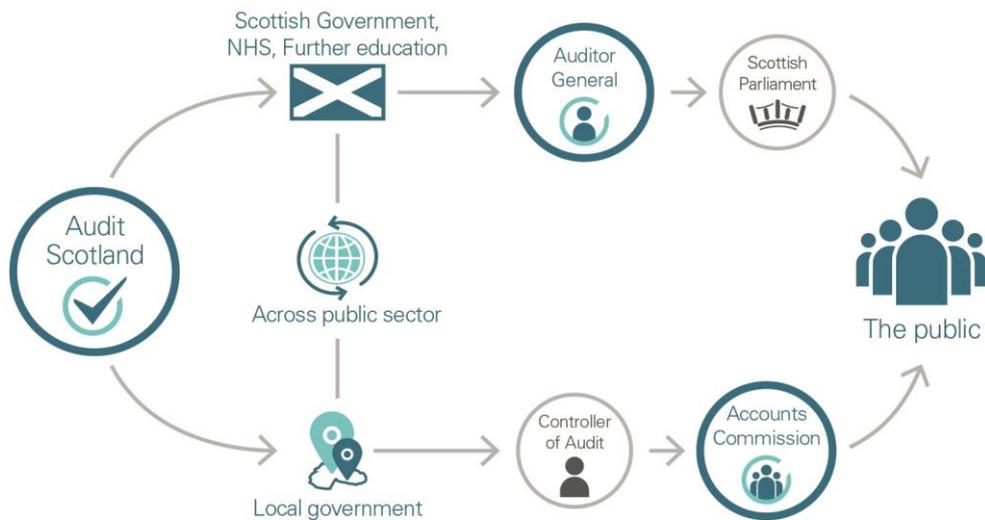
Prepared for Highlands and Islands Enterprise and the Auditor General for Scotland

25 September 2020

## Who we are

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

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



## About us

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

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

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

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# Key messages

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## Audit of 2019/20 annual report and accounts

- 1** The financial statements of Highlands and Islands Enterprise (HIE) and its group give a true and fair view of the financial position as at 31 March 2020 and of the net expenditure for the year.
- 2** The expenditure and income in the financial statements were incurred or applied in accordance with applicable enactments and guidance.
- 3** The other information in the annual report and accounts is consistent with the financial statements and was prepared in accordance with legal requirements.
- 4** An 'Emphasis of Matter' paragraph is included in the independent auditor's report to draw attention to the impact of Covid-19 on property valuations. The audit opinion is not modified in respect of this matter.

## Financial management

- 5** HIE has effective financial management arrangements. It remained within its overall grant in aid budget for 2019/20.
- 6** Financial systems of internal control operated effectively during 2019/20.
- 7** Appropriate arrangements are in place for the prevention and detection of fraud and corruption.

## Financial sustainability

- 8** HIE is updating its 2020/21 budget to reflect the impact of Covid-19. It expects to continue supporting the Scottish Government's long-term recovery plans but the implications on its funding are not yet known.
- 9** HIE continues to face significant financial challenges and uncertainties, not least related to the funding of activities on Cairngorm Mountain and the reinstatement of the funicular railway.

## Governance and transparency

- 10** HIE has appropriate and effective governance. It has made changes to its operating environment and governance arrangements in response to the impact of Covid-19.
- 11** The performance report included in the annual report and accounts meets the requirements of the Financial Reporting Manual (FRM), with scope for further improvement.

## Value for money

- 12** HIE has an appropriate best value framework in place.
- 13** Underlying uncertainties in the business environment and Covid-19 are affecting HIE's performance.

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# Introduction

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1. This report summarises the findings from our 2019/20 audit of Highlands and Islands Enterprise (HIE).

2. The scope of our audit was set out in our Annual Audit Plan presented to the March 2020 meeting of the Risk and Assurance Committee. This report comprises the findings from:

- an audit of HIE's annual report and accounts
- consideration of the four audit dimensions that frame the wider scope of public audit set out in the [Code of Audit Practice 2016](#) as illustrated in [Exhibit 1](#).

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## Exhibit 1 Audit dimensions



Source: *Code of Audit Practice 2016*

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3. The main elements of our audit work in 2019/20 have been:

- a review of HIE's key financial systems
- an audit of HIE's 2019/20 annual report and accounts including the issue of an independent auditor's report setting out our opinions
- consideration of the four audit dimensions.

**4.** In common with all organisations, HIE has had to respond to the global coronavirus (Covid-19) pandemic. This affected the final weeks of the financial year and will continue to have significant impact in 2020/21. HIE and the other enterprise agencies are managing the Scottish Government Covid-19 related business support funds. This includes the Creative, Tourism & Hospitality Enterprises Hardship Fund (£30 million), the Pivotal Enterprise Resilience Fund (£120 million) and the Supporting Communities Fund (£40 million).

**5.** As we undertook our audit planning work prior to the pandemic, we reviewed our assessment of audit risks and the planned audit work in May 2020 and concluded that they remained relevant.

**6.** As part of our 2019/20 audit, we planned to review how HIE demonstrates compliance with the Equality Act 2010, and how it is advancing equalities within and outwith the organisation. Due to the impact of Covid-19 on audit resources and timetables, we will complete and report this work as part of our 2020/21 audit.

### **Adding value through the audit**

**7.** We add value to HIE through the audit by:

- identifying and providing insight on significant risks, and making clear and relevant recommendations
- sharing intelligence and good practice through our national reports ([Appendix 3](#)) and good practice guides
- providing clear and focused conclusions on the appropriateness, effectiveness and impact of corporate governance, performance management arrangements and financial sustainability.

### **Responsibilities and reporting**

**8.** HIE has primary responsibility for ensuring the proper financial stewardship of public funds. This includes preparing an annual report and accounts that are in accordance with the account's direction from Scottish Ministers.

**9.** HIE is also responsible for establishing appropriate and effective arrangements for governance, propriety and regularity that enable the Board to successfully deliver its objectives.

**10.** Our responsibilities as independent auditor are established by the Public Finance and Accountability (Scotland) Act 2000 and the [Code of Audit Practice 2016](#), and supplementary guidance and International Standards on Auditing in the UK. As public sector auditors we give independent opinions on the annual report and accounts.

**11.** Additionally, we conclude on the appropriateness and effectiveness of the performance management arrangements, the suitability and effectiveness of corporate governance arrangements, the financial position and arrangements for securing financial sustainability. Further details of the respective responsibilities of management and the auditor can be found in the [Code of Audit Practice 2016](#) and supplementary guidance.

**12.** This report raises matters from our audit. Weaknesses or risks identified are only those which have come to our attention during our normal audit work and may not be all that exist. Communicating these does not absolve management from its responsibility to address the issues we raise and to maintain adequate systems of control.

**13.** Our annual audit report contains an agreed action plan at [Appendix 1](#). It sets out specific recommendations, the responsible officer(s) and dates for implementation. It also includes any outstanding actions from last year and progress against these.

## **Auditor independence**

**14.** 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 comply with professional standards issued by the Financial Reporting Council and those of the professional accountancy bodies.

**15.** We can confirm that we comply with the Financial Reporting Council's Ethical Standard. We can also confirm that we have not undertaken any non-audit related services. The 2019/20 audit fee of £137,970 as set out in our Annual Audit Plan remains unchanged. We are not aware of any relationships that could compromise our objectivity and independence.

**16.** This report is addressed to both HIE and the Auditor General for Scotland and will be published on Audit Scotland's website [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk) in due course.

**17.** We would like to thank management and staff who have been involved in our work for their co-operation and assistance during the audit, particularly given the current challenges presented by the impact of Covid-19.

# Part 1

## Audit of 2019/20 annual report and accounts



### Main judgements

The financial statements of HIE and its group give a true and fair view of the financial position at 31 March 2020 and the net expenditure for the year.

The expenditure and income in the financial statements were incurred or applied in accordance with applicable enactments and guidance.

The other information in the annual report and accounts is consistent with the financial statements and was prepared in accordance with legal requirements.

An 'Emphasis of Matter' paragraph is included in the independent auditor's report to draw attention to the impact of Covid-19 on property valuations. The audit opinion is not modified in respect of this matter.

The annual report and accounts are the principal means of accounting for the stewardship of resources and performance.

### Our audit opinions on the annual report and accounts are unmodified

**18.** The annual report and accounts for the year ended 31 March 2020 were approved by the Risk and Assurance Committee on 23 September 2020. We reported within the independent auditor's report that:

- the financial statements give a true and fair view and were properly prepared
- the expenditure and income were regular and in accordance with applicable enactments and guidance
- the performance report, governance statement and audited part of the remuneration and staff report were all consistent with the financial statements and properly prepared in accordance with the relevant legislation and directions made by Scottish Ministers.

**19.** . We have included an 'Emphasis of Matter' paragraph in our independent auditor's report which refers to the impact of Covid-19 on the valuations of land and buildings. Emphasis of Matter paragraphs are added to auditors' reports where the auditor considers it necessary to draw users' attention to matters disclosed in the accounts which are fundamental to the understanding of the accounts. The Statement of Accounting Policies (Critical Accounting Estimates and Judgements) in the financial statements describes the uncertainty caused. The audit opinion is not modified in respect of this matter. Further information is contained in [Exhibit 3](#) below.

**20.** In accordance with the whole of government accounts (WGA) guidance we plan to complete the required assurance statement and submit it to the National Audit Office (NAO). We await confirmation of the revised deadline for completing the assurance statement but understand that this will be 30 November 2020 at the earliest.

## The annual report and accounts were signed off later than originally planned due to Covid-19

**21.** HIE and Audit Scotland staff worked from home for the duration of the audit due to the Covid-19 pandemic and this presented challenges for both the Finance team at HIE and the Audit Scotland audit team. As a result, the audit took longer than normal to complete.

**22.** The working papers provided to support the accounts were generally of a good standard and the audit team received good support from the finance team. Regular communication and good working relationships between the finance and audit teams helped ensure the audit ran smoothly, and despite the challenges of lockdown, we completed the audit within six weeks of the date originally planned.

## Overall materiality is £970,000

**23.** The assessment of what is material is a matter of professional judgement. It involves considering both the amount and the nature of a misstatement in the financial statements.

**24.** On receipt of the unaudited annual report and accounts we reviewed our materiality calculations and updated them as set out in [Exhibit 2](#).

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## Exhibit 2 Materiality values

Materiality level	Single Entity	Group
Overall materiality	£970,000	£980,000
Performance materiality	£390,000	£390,000
Reporting threshold	£50,000	£50,000

Source: Audit Scotland

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## Main risks of material misstatement and how we addressed these

**25.** [Appendix 2](#) provides our assessment of risks of material misstatement in the annual report and accounts and any wider audit dimension risks. These risks influence our overall audit strategy, the allocation of staff resources to the audit and indicate how the efforts of the audit team were directed. [Appendix 2](#) also identifies the work we undertook to address these risks and our conclusions.

**26.** We undertook our planning work and issued our 2019/20 annual audit plan in early March 2020, prior to the Covid-19 pandemic. In line with auditing standards and professional advice, including the [Financial Reporting Council's Covid-19 bulletin](#) published in March 2020, we reviewed our assessment of audit risks and the planned audit work in May 2020 and concluded that they remained relevant. There have not been any changes to audit risks or our audit approach.

**27.** Matters arising from our work on the risks of material misstatements include risks relating to management judgement and estimation and are discussed further at [Exhibit 3](#) below.

## Significant findings from the audit of the financial statements

28. International Standard on Auditing (UK) 260 requires us to communicate significant findings from the audit to those charged with governance, including our view about the qualitative aspects of the body's accounting practices. We have no significant findings to report around the qualitative aspects of the body's accounting policies, accounting estimates and financial statements disclosures. The significant findings are summarised in [Exhibit 3](#).

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### Exhibit 3

#### Significant findings from the audit of financial statements

Issue	Resolution
<p><b>1. Impact of Covid-19 on the valuation of land and buildings</b></p> <p>HIE's land and buildings (£27.2million) are revalued annually by an external valuer, Graham and Sibbald.</p> <p>Graham and Sibbald's report contains a 'material valuation uncertainty' clause regarding the impact of Covid-19. It points out that a higher degree of caution should be attached to the valuation than would normally be the case.</p> <p>The unaudited accounts did not refer to this material uncertainty.</p>	<p>We discussed this with Finance staff who agreed to include an appropriate disclosure in the accounting policy on critical accounting estimates and judgements.</p> <p>We added an Emphasis of Matter paragraph to the independent auditor's report because we believe the disclosure is fundamental to users' understanding of the accounts. The audit opinion is not modified in respect of this matter.</p> <p>We have sought and received the Accountable Officer's assurances on management's assessment of the fair value of land and property in the ISA 580 representation letter.</p>
<p><b>2. Event after reporting period - outstanding VAT liability</b></p> <p>The unaudited accounts included entries in relation to the VAT liability resulting from an HMRC investigation. The entries were management's assessment of the position at that time, including a payment on account in March 2020.</p> <p>The input tax part of the investigation was settled in July 2020 with no penalties payable.</p> <p>The output tax part of the investigation has yet to be settled. HIE expects to settle the remainder of this case during 2020/21.</p>	<p>Management has updated the accounts to reflect the additional information. The misclassification of the payment on account as a prepayment was also corrected.</p> <p>The amendments reduced net expenditure by £1.3 million, trade receivables by £2.2 million, trade payables by £3 million, and provisions by £0.5 million; and increased taxpayers' equity by £1.3 million.</p> <p>An 'events after the reporting period' disclosure has also been included in the annual report and accounts.</p> <p>We are content with the accounting adjustments and disclosures.</p>
<p><b>3. Event after reporting period – increased costs of reinstatement of Cairngorm funicular</b></p> <p>The unaudited accounts included a provision of £14.3 million for the estimated costs of reinstatement of the funicular. In July 2020, the HIE Board approved the final business case which contained updated costs.</p>	<p>Management has updated the accounts to reflect receipt of this additional information.</p> <p>The amendment increased net expenditure and provisions and reduced taxpayers' equity by £0.2 million.</p> <p>An 'events after the reporting period' disclosure has also been included in the annual report and accounts.</p> <p>We are content with the accounting adjustments and disclosures.</p>

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Issue	Resolution
<p><b>4. Event after the reporting period - updated IAS 19 (pensions) disclosures</b></p> <p>The McCloud ruling found that the transitional protection provided as part of the 2015 public service pensions scheme changes discriminate on the grounds of age. In August 2020, HIE's actuaries advised that updated information was available in relation to the impact of the McCloud ruling on the pension disclosures included in the unaudited accounts.</p> <p>The actuaries provided revised IAS19 reports which were used to update the accounts.</p>	<p>Management has updated the accounts to reflect receipt of this additional information.</p> <p>The amendment reduced net expenditure by £0.1 million, reduced other comprehensive income by £0.2 million and increased net pension liabilities and the pensions reserve by £0.1 million.</p> <p>An 'events after the reporting period' disclosure has also been included in the annual report and accounts.</p> <p>We are content with the accounting adjustments and disclosures.</p>
<p><b>5. Expenditure on Space Hub Sutherland</b></p> <p>Expenditure totalling £2.2 million on Space Hub Sutherland had been treated as expenditure in the unaudited accounts.</p> <p>We questioned whether this expenditure should have been treated as assets under construction in HIE's accounts as it was incurred as part of the development of a non-current asset.</p>	<p>We discussed this with Finance staff who agreed that this expenditure should be treated as an 'asset under construction' in the audited accounts. As HIE impairs its assets under construction, the valuer provided a valuation for the asset at 31 March 2020.</p> <p>The amendment reduced net expenditure and increased non-current assets and taxpayers' equity by £0.2 million.</p> <p>Management has updated the accounts to correct this misstatement. We are content with the accounting adjustments and disclosures.</p> <p>We have sought and received the Accountable Officer's confirmation that all assets under construction are classified as such.</p>
<p><b>6. Classification of provision for reinstatement of the Cairngorm funicular</b></p> <p>As noted above, the unaudited accounts contained provision for reinstatement of the Cairngorm funicular. This had been treated as current liabilities in the unaudited accounts. The project is expected to last two years and so current provisions were overstated, and non-current provisions were understated by £1.7 million.</p>	<p>Management agreed to amend the accounts to correct this misclassification. There is no impact on taxpayers' equity. We are content with the accounting adjustments and disclosures.</p> <p> <a href="#">Recommendation 1 (prior year)</a></p>
<p><b>7. Classification of IAS19 accounting adjustment</b></p> <p>The IAS19 accounting adjustment for pension costs was included in general administration in the unaudited accounts. As a result, general administration costs were understated, and staff costs overstated by £0.4 million.</p>	<p>Management agreed to amend the accounts to correct this misclassification. There is no impact on taxpayers' equity. We are content with the accounting adjustments and disclosures.</p> <p> <a href="#">Recommendation 1 (prior year)</a></p>
<p><b>8. Classification of non-current assets</b></p> <p>Capital expenditure of £2 million was treated as an addition to non-current assets rather than as an asset under construction in the unaudited accounts. This asset (north bridge on the campus) was not complete as at 31 March 2020 and should, therefore, be classed as an asset under construction at the year-end.</p>	<p>Management agreed to amend the accounts to correct this misclassification. There is no impact on taxpayers' equity. We are content with the accounting adjustments and disclosures.</p> <p> <a href="#">Recommendation 1 (prior year)</a></p>

## The financial statements were adjusted to reflect information received after the reporting period and other audit findings resulting in a decrease in net liabilities of £1.2 million

**29.** Presentational and monetary adjustments to the accounts identified during the audit were discussed with management who agreed to amend the financial statements.

**30.** There were four material adjustments to the annual accounts presented for audit (items 2, 5, 6 and 8 in [Exhibit 3](#)). The adjustments reflected the full extent of the potential misstatement for items 2 and 6 and so no further audit procedures were required. We reviewed the non-current assets additions for other assets which should have been included in assets under construction at the year-end, but none were identified. Additionally, our testing of revenue expenditure transactions did not identify any other transactions that we would expect to be capitalised.

**31.** The net effect of the adjustments identified during the audit and processed by management was to decrease HIE's single entity and group net expenditure by £1.4 million, decrease other comprehensive income by £0.2 million and decrease net liabilities by £1.2 million.

**32.** There is one adjustment above our reporting thresholds which was not made in the audited accounts. HIE received a revised assessment from HMRC in September 2020 which reduced its net VAT liability by £0.3 million from the position included in the audited accounts. Had this adjustment been made, net expenditure and net liabilities would have decreased, and taxpayers' equity would have increased by £0.3 million.

## Other matters arising from the audit of the financial statements

**33. Cairngorm Mountain:** during 2019/20, HIE provided a further loan of £0.3 million to Cairngorm Mountain (Scotland) Limited (CMSL) and converted £0.6 million of the existing loan to shares. As at 31 March 2020, HIE held £1.1 million of shares in CMSL and £0.4 million of loans were outstanding. These balances have been impaired by 90% in the accounts to reflect the current economic climate (CMSL had to close operations in line with Scottish Government guidance in response to Covid-19 which curtailed the 2019/20 ski season) and the losses reported in 2019/20.

**34.** HIE provided funding totalling £1.3 million to CMSL during 2019/20 and as at 31 March 2020, CMSL recorded a deficit of £0.4 million which has been included in HIE's group accounts. In addition, HIE spent £0.9 million to support sustainable development of Cairngorm Mountain including costs associated with preparation of the Cairngorm Mountain masterplan.

**35. Capital accounting:** we identified a number of issues relating to capital accounting. Although the amounts involved were below our reporting threshold, they demonstrate the need for HIE to develop its understanding in this area, particularly accounting for revaluations. Management amended the audited accounts for the majority of these issues. Those that were not amended are immaterial and do not impact on our audit opinion.

**36. Presentation of the annual accounts:** during the audit we highlighted areas where the presentation and content could be improved. Examples include the cash flow statement, which could be simplified, and the financial performance information in the parliamentary accountability report, to facilitate read across to the main financial statements. More generally, there are opportunities to remove unnecessary lines in the financial statements which would streamline the document and make it more readable.



## Recommendation 1

**HIE should review the presentation of the financial statements, including the cash flow statement and parliamentary accountability report, to ensure they are clear, concise and facilitate use of the accounts.**

**37. Guaranteed Minimum Pension (GMP):** the courts have ruled that UK defined benefit pension schemes must compensate members for differences attributable to guaranteed minimum pensions (GMPs). HIE's actuary's general advice is that a 'trigger event' has yet to occur. HIE has added a contingent liability note to its accounts to explain and disclose this matter. We are content with this disclosure.

**38. Goodwin tribunal:** the Goodwin tribunal case changes the pension entitlement of male survivors in opposite sex marriages to take into account the female member's service from 6 April 1978. Previously, entitlement was based on service accrued from 6 April 1988. The change is backdated to 5 December 2005 and affects the pensions of male spouse survivors whose entitlement arose on or after this date. HIE has added a contingent liability note to its accounts to explain and disclose this matter. We are content with this disclosure

### Finance team capacity has been reviewed and enhanced

**39.** Last year we recommended that HIE reviews whether its finance team had sufficient financial skills and capacity to meet its needs. In November 2019, the Director of Finance and Corporate Services updated the Risk and Assurance Committee on the results of his review. He reported that the vacant graduate trainee post was to be re-advertised and that an additional qualified accountant with financial accounting experience would be recruited to increase capacity and expertise within the finance team.

**40.** The graduate trainee post was filled in November 2019 and the qualified accountant started working with HIE in April 2020. As a result of remote working, the accountant had limited input to the year-end accounts preparation processes this year due to lack of familiarity with HIE's financial systems.

**41.** We are pleased to note the increase in the finance team's capacity and will consider the impact these new posts have had on the team's financial skills and capacity as part of our 2020/21 audit.

### Some progress was made on prior year recommendations

**42.** HIE has made some progress in implementing our prior year audit recommendations. For actions not yet fully implemented, revised responses and timescales have been agreed with management, and are set out in [Appendix 1](#).

# Part 2

## Financial management



### Main judgements

HIE has effective financial management arrangements. It remained within its overall grant in aid budget for 2019/20.

Financial systems of internal control operated effectively during 2019/20.

Appropriate arrangements are in place for the prevention and detection of fraud and corruption.

Financial management is about financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.

### HIE operated within budget in 2019/20

43. HIE's main financial objective is to ensure that the financial outturn for the year is within the budget allocated by Scottish Ministers. HIE and its group reported an outturn of £67.6 million for 2019/20 against a resource budget of £73.4 million, an underspend of £5.8 million. HIE's financial performance against Departmental Expenditure Limits (DEL) is shown in [Exhibit 4](#).

### Exhibit 4 Performance against DEL in 2019/20

Performance	Initial budget	Autumn Budget Review	Spring Budget Review	Final budget	Outturn	Over/(under) spend
	£m	£m	£m	£m	£m	£m
Resource DEL*	29.500	+0.456	+7.914	37.870	33.939	(3.931)
Capital DEL	25.500	+5.835	-1.863	29.472	31.905	2.433
Financial transactions	1.000	-	-	1.000	0.875	(0.125)
<b>Total cash DEL</b>	<b>56.000</b>	<b>+6.291</b>	<b>+6.051</b>	<b>68.342</b>	<b>66.719</b>	<b>(1.623)</b>
Non-cash DEL	5.035	-	-	5.035	0.851	(4.184)
<b>Total DEL</b>	<b>61.035</b>	<b>+6.291</b>	<b>+6.051</b>	<b>73.377</b>	<b>67.570</b>	<b>(5.807)</b>

Source: Grant in Aid Letters and HIE 2019/20 Annual Report and Accounts. \*Note: HIE identified that the final GIA letter overstated the final budget for RDEL by £0.1 million due to an error in the brought forward figure. Exhibit 4 shows the figure less the £0.1 million.

**44.** HIE overspent its Annually Managed Expenditure (AME) budget by £5.5 million. AME can be volatile and includes amounts such as accounting provisions and impairments. The excess of expenditure over the AME allocation is largely due to the increase in the provision for the reinstatement of the funicular railway.

### **HIE received additional grant in aid funding totalling £12.3 million during the year**

**45.** HIE received an initial grant in aid budget of £56 million (excluding non-cash DEL) for 2019/20. During the year it received additional funding from the Scottish Government in the Autumn and Spring Budget Revisions totalling £12.3 million:

- additional RDEL received included: £4.5 million for the VAT liability resulting from the HMRC investigation, £2.5 million for the anticipated losses for HIE's subsidiary Cairngorm Mountain Limited Scotland Limited (CMSL); and £1 million to fund the Cairngorm Masterplan.
- additional CDEL was received in respect of funding for Wave Energy Scotland (£10 million), and the Cairngorm business case (£2.1 million). This was partially offset by £8.5 million of CDEL which HIE returned following the sale of the Centre for Health Sciences. This will be drawn down in future years to help fund work on the funicular.

**46.** In addition, the Scottish Government agreed that HIE could overspend its CDEL allocation by up to £2.9 million to cover the costs of developing Nigg East Quay. HIE was also permitted to draw down an additional £2.2 million of grant in aid to fund a payment on account to HMRC.

### **Effective arrangements are in place for budget monitoring**

**47.** Our review of the Board's budget monitoring and control processes concluded that effective arrangements are in place. Budget monitoring reports are regularly presented to the Board and monthly management accounts are prepared. HIE's progress against budget and its financial position are discussed at every meeting of the Leadership Team.

### **Financial systems of internal control operated effectively during 2019/20**

**48.** As part of our audit we identify and inspect the key internal controls in those accounting systems which we regard as significant to produce the financial statements. Our objective is to gain assurance that HIE has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements.

**49.** Our Management Report, presented to the Risk and Assurance Committee in June 2020, reported the findings from our review of HIE's key financial systems. We concluded that the controls tested were operating satisfactorily. No significant internal control weaknesses were identified during the audit which could affect HIE's ability to record, process, summarise and report financial and other relevant data properly.

### **Internal audit is effective**

**50.** We reviewed HIE's internal audit arrangements in accordance with International Standard on Auditing (UK) 610 (Using the Work of Internal Auditors) to determine the extent to which we could use the work of internal audit.

**51.** Internal audit is provided by an in-house team supported by additional resources provided by a firm of accountants. Specialist IT audit services are provided by an independent third party on behalf of HIE and their partners in Enterprise Information Services (EIS), the shared IT arrangement with Skills Development Scotland (SDS) and Scottish Enterprise (SE).

**52.** Our review concluded that HIE's internal audit arrangements are effective. We placed reliance on internal audit's testing of significant transactions and work on the certificates of assurance to support our audit opinion. We also considered their work on procurement and openness and transparency to support our wider dimension audit responsibilities.

### **Standards of conduct and arrangements for the prevention and detection of fraud and error are appropriate**

**53.** Audited bodies are responsible for establishing arrangements for the prevention and detection of fraud, error and irregularities, bribery and corruption, and to ensure that their affairs are managed in accordance with proper standards of conduct by putting effective arrangements in place.

**54.** We reviewed the arrangements in place at HIE to maintain standards of conduct including the staff code of conduct. We also reviewed the whistle-blowing policy and the counter fraud and bribery policy.

**55.** We concluded that there are established procedures for preventing and detecting any breaches of these standards including any instances of corruption. We are not aware of any specific issues that we need to bring to your attention.

**56.** Audit Scotland published its [National Fraud Initiative 2018/19 report](#) in July 2020. We published a supplementary report alongside this which highlights some of the [emerging fraud risks](#) during the Covid-19 pandemic. It provides examples of the increased risks around governance, procurement, funding, payroll/recruitment, IT/cyber, and health and wellbeing as well as examples of how to mitigate against these.

### **Arrangements for preventing fraud and corruption in the procurement function are appropriate**

**57.** Our consideration of financial management this year included an evaluation of HIE's arrangements for preventing and detecting fraud and corruption in its procurement function.

**58.** We reported the findings in our Management Report which was presented to the Risk and Assurance Committee in June 2020. We concluded that HIE has appropriate arrangements to mitigate fraud in its procurement activities.

**59.** Internal audit completed a review of procurement in May 2020. This concluded that, for the most part, procurement rules were followed with scope for improvement. This included the need to ensure clear justification and approval where procedures are not followed and appropriate audit trails.

# Part 3

## Financial sustainability



### Main judgements

**HIE is updating its 2020/21 budget to reflect the impact of Covid-19. It expects to continue supporting the Scottish Government's long-term recovery plans but the implications on its funding are not yet known.**

**HIE continues to face significant financial challenges and uncertainties, not least related to the funding of activities on Cairngorm Mountain and reinstatement of the funicular railway.**

Financial sustainability looks forward to the medium and longer-term to consider whether a body is planning effectively to continue to deliver its services or the way in which they should be delivered.

### The 2020/21 budget is under review for the impact of Covid-19

**60.** The 2020/21 budget setting process began in February 2020 with the Board's consideration of the draft budget for the year. This was revised to reflect the anticipated impact of Covid-19 and the revised budget was approved by the Board in April 2020. The approved budget shows that HIE plans to spend £67.4 million (revenue and capital) in 2020/21. This will be funded by £58.4 million grant in aid from the Scottish Government, and revenue (£2.3 million) and capital (£2.4 million) receipts. As in previous years, the approved budget includes an element (£4.3 million) of 'over-programming' which HIE will manage through expected slippage in spending plans and additional funding requests.

**61.** In response to Covid-19, the Scottish Government issued an interim letter of guidance to all enterprise and skills bodies in April 2020. This noted that the challenges caused by the pandemic would likely supersede 2020/21 business planning. The guidance acknowledged that, whilst agencies would need to deliver contractual commitments, all other resources should be prioritised to meet the emerging fiscal, economic and social challenges posed by Covid-19.

**62.** Since April 2020, HIE has worked with public sector partners, including Scottish Enterprise, South of Scotland Enterprise, Creative Scotland and Visit Scotland to deliver grant funding to support businesses adversely impacted by Covid-19. This has been done through the Creative, Tourism & Hospitality Enterprises Hardship Fund, the Pivotal Enterprise Resilience Fund, and the Supporting Communities Fund which have a combined total £190 million funding. As at 31 August 2020, HIE has processed 983 applications with awards of over £28.5 million offered to applicants.

**63.** HIE has also considered alternative support that can be provided to private sector bodies. In accordance with Scottish Government guidance, it has allowed rental concessions for commercial property tenants and loan repayments have been rescheduled.

**64.** Given the ongoing impact of Covid-19 and changes to its operating environment, HIE is currently reviewing its 2020/21 budget to reflect the evolving position.

**65.** The Covid-19 pandemic will have a substantial impact on public finances in 2020/21 and it is likely that funding will require to be reprioritised across public sector bodies. It expects to continue supporting the Scottish Government's long-term recovery plans but the implications on its funding are not yet known.

### **HIE faces significant financial risks and uncertainties in 2020/21**

**66.** HIE faces significant financial risks and uncertainties in 2020/21. The approved budget includes key assumptions in relation to these:

- the Space Hub Sutherland project and reinstatement of the Cairngorm funicular railway will continue to be eligible for funding through the capital allocation from the Scottish Government
- the impact of the proposed new methodology for calculating non-recoverable VAT will not exceed £2 million
- all EU funding due in 2020/21 will be successfully reclaimed
- the impact of Covid-19 will not result in the loss of rental or other income (i.e. income will be deferred but not written-off)
- commitments that are not currently funded will experience significant slippage.

**67.** In addition to Space Hub Sutherland and reinstatement of the Cairngorm funicular, work is also due to start on development of Nigg East Quay. Funding of £8.3 million is available to spend on this project in 2020/21. HIE acknowledges that it will be challenging to manage these financial pressures alongside the uncertainty caused by Covid-19.



### **Recommendation 2**

**HIE should keep its financial plans under close review during 2020/21 so that it is able to take early and informed decisions which deal with the financial challenges it faces.**

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### **Determining a long-term, sustainable future for Cairngorm Mountain is central to financial sustainability**

**68.** Last year we reported that the Auditor General had decided to prepare a report on Cairngorm and the funicular railway under section 23 of the Public Finance and Accountability (Scotland) Act 2000. This report, [HIE's Management of Cairngorm Mountain and Funicular Railway](#), was published in June 2020. An extract of the key messages contained in the Auditor General's report is set out in [Exhibit 5](#).

## Exhibit 5

### Extract from key messages in section 23 report

- although HIE's subsidiary, Cairngorm Mountain Limited (CML), operated the ski area between 2008 and 2014 HIE always intended this to be a temporary measure and sold CML to Natural Assets Investment Limited (NAIL) in 2014 because it considered this would maximise the economic benefits for the area. HIE's process for selecting a new operator was appropriate. It carried out due diligence and took steps to protect its decision to transfer CML to NAIL through financial guarantees
- the contract agreed between HIE and CML in 2014 set out the responsibilities of each party. Monitoring arrangements were in place and HIE assured itself that CML had appropriate maintenance and repair procedures in place to meet its obligations. Given the financial risks HIE identified before the transfer of CML to NAIL, it would have been in HIE's interests to review NAIL's financial standing on an ongoing basis. This could have left HIE better placed to react had NAIL been unable to continue supporting CML
- HIE was aware that CML was facing financial and operational difficulties in the summer of 2018 and was able to act quickly when CML went into administration in November 2018. Its actions were effective in securing the assets and business activities at Cairngorm Mountain. HIE's current preferred option is to reinstate the funicular railway by completion of remedial structural work at an indicative cost of £10-15 million. This is subject to completion of an objective options appraisal and final business case, and HIE Board and Scottish Government approval. HIE is considering the impact of the current Covid-19 pandemic on costs and timescales while making its final decision
- HIE is working to stabilise the business and reinstate the funicular railway while putting long-term plans in place for the wider mountain estate. This continues to put a strain on HIE's staff and finances. HIE and the Scottish Government face tough decisions on how to secure a sustainable and affordable operation at Cairngorm Mountain, taking account of the wide-ranging interests of stakeholders.

Source: HIE's Management of Cairngorm Mountain and Funicular Railway.

**69.** Since the section 23 report was published, the HIE Board has approved a business case subject to satisfactory conclusion of contractual negotiations and Scottish Government confirmation of approval and funding. HIE is working to conclude the process. The 2019/20 accounts include a provision of £14.6 million for the required work based on the latest cost estimates (July 2020). £8.5 million has been set aside from the sale of the Centre for Health Sciences to help fund this work. HIE is in discussion with the Scottish Government about the funding for the remainder

**70.** It is crucial that HIE determines a long-term sustainable future for the mountain. Any future decisions, including public subsidies that are necessary to continue operations, must take into account not only the economic benefits that the resort can bring to the wider area but also their community, social and environmental impact. Consultation of HIE's 'Cairngorm Mountain – towards a vision and masterplan' document has recently closed. This aims to agree a consensus vision for the future of Cairngorm Estate, with strategies that can be delivered in the short, medium and longer term to unlock its potential as both an environmental and economic asset.

**71.** Cairngorm Mountain will continue to put strain on HIE's finances and its plans for financial sustainability for the foreseeable future. We will continue to monitor developments.

## **HIE's pension fund deficit reduced during 2019/20 but it remains a significant longer-term liability**

**72.** HIE's pension schemes are in deficit with liabilities exceeding assets by £42 million (2018/19: £47.4 million) resulting in a net liabilities balance of £18.4 million on HIE's statement of financial position. The HIE pension scheme accounts for most of this deficit with an excess of liabilities over assets of £38.9 million as at 31 March 2020 (£41.8 million as at 31 March 2019).

**73.** Following the 2012 triennial valuation, HIE implemented a recovery plan, including lump sum employer contributions and increasing members' contribution rate, to address the deficit on its pension scheme. HIE made two lump sum payments during 2019/20 totalling £1.1 million to reduce the pension deficit.

**74.** The Scottish Government has provided HIE with guarantees for the local government pension schemes to cover the costs associated with any cessation event (triggered when HIE no longer has any active members in a pension scheme). This is an important safeguard as HIE is a member of three local government pension schemes with decreasing numbers of active members.

**75.** Work is ongoing on the triennial valuations of all local government pension schemes with the results expected in early 2021. These valuations will form the basis of future employer contribution rates with effect from 1 April 2021. The next triennial valuation of the HIE pensions scheme is due as at 31 March 2021.

# Part 4

## Governance and transparency



### Main judgements

**HIE has appropriate and effective governance arrangements in place. It made changes to its operating environment and governance arrangements in response to the impact of Covid-19.**

**The performance report included in the annual report and accounts meets the requirements of the FReM, with scope for further development.**

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.

### Overall governance arrangements were appropriate

**77.** HIE is governed by a Board that is accountable to Scottish Ministers. During the year the Chair's appointment ended (February 2020) and the Chief Executive took an extended leave of absence. Interim arrangements were put in place to cover for these key roles and as at 31 March 2020, the Board consisted of the acting Chair, ten non-executive members, and the interim Chief Executive. The acting Chair was appointed as Chair in May 2020 and the Chief Executive resumed her duties as Accountable Officer on 21 April 2020.

**78.** There were six Board meetings in 2019/20. The Board is supported by two sub-committees: risk and assurance (RAC), and remuneration. HIE also established sub-groups, in November 2018 to consider issues related to Cairngorm Mountain, and in May 2019 to consider issuing related Space. Both of these groups met 23 times during 2019/20.

**79.** The RAC met four times during 2019/20. Agendas follow a standard format and papers are circulated to members in advance, allowing adequate time for members to review. We attend all RAC meetings and are satisfied that members provide appropriate scrutiny of submitted reports.

**80.** In assessing governance and transparency, we consider:

- Board and committee structure and conduct
- overall arrangements and standards of conduct including those for the prevention and detection of fraud, error, bribery and corruption. This includes action in response to the National Fraud Initiative
- openness of Board and committees
- public access to information via websites
- reporting of performance and whether this is fair, balanced and understandable.

**81.** Overall, we concluded that HIE had appropriate governance arrangements in place during 2019/20 although there is scope to improve openness and transparency (see paragraphs 86 to 89 below).

### Covid-19 has affected governance arrangements

**82.** HIE has amended its governance arrangements as a result of the Covid-19 pandemic. HIE's Business Continuity Group led the initial response to the pandemic and implemented the existing incident management and response plan. As a result, HIE staff have been able to continue to operate during the lockdown period.

**83.** In our Annual Audit Plan, we noted that HIE had yet to prepare business continuity plans for all its key locations. In early March 2020, HIE tested its business continuity planning arrangements to ensure that all staff had the equipment and ability to work from home. As lockdown continued, staff were permitted to purchase additional equipment, such as keyboards and mice, to improve their home working environment. HIE's response to the pandemic also included:

- holding all Board and committee meetings virtually with no changes required to the original dates
- preparing a Covid-19 risk register which is regularly review and updated and reported to the HIE Board
- regular communication with staff, and preparation of guidance for employees which is regularly updated.

**84.** HIE has been proactive in dealing with the changed operating environment. We will assess the new arrangements as part of our 2020/21 audit. The scale and pace of change as a result of Covid-19 poses a risk that key financial controls will not operate as intended and we have recommended that arrangements should be put in place to ensure that these remain effective.



### Recommendation 3

#### **HIE should ensure that internal controls remain effective during this period of uncertainty and new ways of working.**

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**85.** There is a wide range of short, medium and long-term risks and issues emerging from Covid-19 for public bodies to consider. In August 2020, Audit Scotland published [Covid-19: Guide for audit and risk committees](#) which focuses on the short-term challenges facing public bodies in the response phase of the pandemic. This guide has been prepared for auditors and public bodies and provides audit and risk committee members with suggested questions to help them effectively scrutinise and challenge in the key areas.

### Openness and transparency could be improved

**86.** There continues to be an increasing focus on demonstrating the best use of public money. Openness and transparency in how a body operates and makes decisions is key to supporting understanding and scrutiny. Transparency means that the public have access to understandable, relevant and timely information about how the Board is taking decisions and how it is using resources such as money, people and assets.

**87.** Last year we reported significant delays in publishing minutes of Board and Risk and Assurance Committee (RAC) meetings on HIE's website. In response, officers advised that they had set a target for minutes of future Board and RAC meetings to be published within 10 working days of their approval. As part of our interim audit, we reviewed HIE's website in April 2020 and concluded that more work was required to ensure that Board and RAC minutes are published within the target timescale. Our review of HIE's website in September 2020 noted that no Board or RAC meetings had been added since our review in April 2020.

**88.** In March 2020, internal audit completed a review of how HIE's approach to openness and transparency compared to other public sector bodies. The report made six recommendations to further improve HIE's openness and transparency, all of which were accepted by management.

**89.** We will continue to review HIE's approach to openness and transparency as part of our 2020/21 audit.

### The performance report could be further improved

**90.** In addition to the opinion on the performance report covered in [Part 1](#) of our Annual Audit Report, we also consider the qualitative aspects of the performance report. The performance report should provide information on the main objectives and the principal risks faced. It should provide a fair, balanced and understandable analysis of a body's performance as well as helping stakeholders understand the financial statements.

**91.** Last year we reported that HIE had improved the presentation and content of its performance report. Our review in 2019/20 concluded that there was scope to provide a more balanced picture of performance during 2019/20. We discussed a range of matters with management who agreed to update the narrative. The revised narrative provides a more complete picture of HIE's challenges, activities and performance throughout 2019/20. We concluded that the audited performance report meets the requirements of the FReM.

**92.** Annex 5 of the FReM gives additional guidance for narrative reporting. It refers to the use of trend analysis, balanced reporting, plain English, use of infographics and encourages public bodies to go beyond the minimum requirements. In our view, HIE's performance report could be enhanced by linking better the individual sections and clarifying the financial performance section so it is easier to follow. Further guidance can be found in Audit Scotland's 2019 report: [Good Practice Note on Performance Reports in Central Government](#).



#### Recommendation 4

**HIE should review the content and presentation of its performance report against Annex 5 of the FReM and Audit Scotland's good practice guide.**

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### EIS governance arrangements have improved and work is ongoing to strengthen cyber security

**93.** HIE's information technology services are mostly managed by the Enterprise Information Services (EIS). EIS is the shared IT arrangement with Skills Development Scotland (SDS) and Scottish Enterprise (SE). The EIS Partnership Board provides the strategic oversight of the EIS partners, which has been in place for just over 10 years. From April 2020, South of Scotland Enterprise has also joined the partnership.

**94.** The partnership has appointed a specialist information systems internal auditor for EIS. Its August 2019 report on cyber security was graded 4 (the second highest priority for attention) with a recommendation to carry out a cyber maturity assessment. EIS is currently implementing this recommendation with the assessment due to conclude in summer 2020. Going forward, the partnership will need to consider the maturity level it wants to achieve. After any identified gaps are addressed, the partnership may look to achieve Cyber Essentials+ accreditation.

**95.** All partners agree that EIS is an appropriate delivery vehicle for information technology and that greater convergence of common digital provision is desirable. More work is ongoing, and we will continue to monitor developments as part of our 202/21 audit.

# Part 5

## Value for money



### Main judgements

**HIE has an appropriate best value framework in place.**

**Underlying uncertainties in the business environment and Covid-19 are affecting HIE's performance.**

Value for money is concerned with using resources effectively and continually improving services.

### HIE has developed an appropriate best value framework

**96.** *Ministerial guidance to Accountable Officers* for public bodies and the *Scottish Public Finance Manual* (SPFM) sets out the accountable officer's duty to ensure that arrangements are in place to secure best value. The guidance sets out the key principles of best value and the requirement to have a systematic approach to self-evaluation and continuous improvement.

**97.** The Chief Executive of HIE is the designated Accountable Officer. A range of processes are in place to help the Accountable Officer demonstrate best value. The annual report and accounts outline HIE's approach to best value. This includes:

- sound and developing corporate governance arrangements to reflect the changing roles and structures within the organisation
- the development of a three-year strategic plan together with an annual business plan
- regular monitoring of budgets and resources
- a systematic approach to risk management
- regular monitoring of the achievement of outcomes.

### Performance reporting has been aligned with the Enterprise and Skills Strategic Board's Strategic Plan

**98.** The Enterprise and Skills Strategic Board (ESSB) is designed to align and coordinate some of the activities of Scotland's enterprise and skills agencies, including HIE, Scottish Enterprise, Skills Development Scotland, and the Scottish Funding Council.

**99.** In October 2018, the ESSB published a Strategic Plan, which contained common policy missions that the enterprise and skills agencies are required to work towards. It also contained a high-level performance framework, against which the ESSB can assess the bodies' progress to achieving these missions.

**100.** HIE's 2019-22 Strategy is designed to align HIE's performance management framework, where relevant, to the ESSB's Strategic Plan. The 2019/20 Operating Plan includes twelve primary measures, which are also used to demonstrate alignment on combined agency working within the ESSB Strategic Plan.

**101.** The Scottish Government has established an Analytical Unit to support the Strategic Board in its decision-making and assessment of the agency's performance. HIE works closely with the Unit to support analytical activities.

**102.** To support the ESSB and coordinate collaboration between the Agencies, the Strategic Plan Joint Working Group (SPJWG) was formed. Membership of the SPJWG is drawn from each of the agencies along with the Sponsor Division and Analytical Unit. The initial focus of the SPJWG was to support the ESSB in developing its strategic plan and ensuring that each agency's own strategic plan aligned. Following publication of the ESSB's strategic plan in October 2018, and the aligned agency plans in April 2019, the group is now focusing on further developing the aligned agency plans and developing the performance framework which was included in the ESSB's strategic plan.

**103.** The day to day performance of individual agencies against their own performance measures is reported to their own boards and management teams, rather than to the ESSB. HIE presents a regular performance report to its Board which sets out performance against each of its twelve primary measures. We have concluded that HIE has effective arrangements in place to monitor the achievement of outcomes.

## **HIE achieved 75% of its primary performance measures for 2019/20**

**104.** Performance against the twelve primary measures is reported in the annual report and accounts. HIE met or exceeded the target range for eight of its twelve (75%) primary measures for 2019/20. Targets were not met for the following four measures:

- increase in international sales  
(Target: £35-£40 million; Actual £33.3 million)
- number of new international exporters  
(Target 25-30; Actual 13)
- number of clients newly engaged in fair work practices  
(Target 35-40; Actual 21)
- number of community organisations with increased capacity  
(Target 20-25; Actual 17).

**105.** The performance report explains why these targets were not met. Uncertainty about Brexit affected business confidence and levels of private sector investment which impacted on HIE's ability to increase participation in international markets. Data for the latter two measures was not able to be fully captured as a result of Covid-19.

## **Covid-19 has had an impact on performance**

**106.** Covid-19 has had an impact on HIE's performance, and recent performance reporting to the Board reflects the very fast-moving environment as the enterprise agencies and Scottish Government react. Performance reports now focus more on the workstreams and activities that will help to restart the economy. There is not yet an approved 2020/21 operating plan given these uncertainties.

## National performance audit reports

**107.** Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. In 2019/20 several reports were published which may be of interest to HIE. These are outlined in [Appendix 3](#). HIE has appropriate arrangements in place for reviewing national reports and agreeing any actions that need to be taken in response to these.

# Appendix 1

## Action plan 2019/20



No.	Issue/risk	Recommendation	Agreed management action/timing
1	<p><b>Presentation of financial statements</b></p> <p>During the audit we highlighted areas where the presentation and content of the financial statements could be improved. Examples include the cash flow statement and the financial performance disclosures in the parliamentary accountability report.</p> <p><b>Risk:</b> users are unable to make best use of and fully understand the financial statements.</p>	<p>HIE should review the presentation of the financial statements, including the cash flow statement and parliamentary accountability report, to ensure they are clear, concise and internally consistent.</p>	<p>We have updated the notes and commentary relating to the statements. We will work with Audit Scotland to understand where further improvements can be made.</p> <p><b>Responsible officer:</b> Head of Financial Services</p> <p><b>Agreed date</b> 30 June 2021</p>
2	<p><b>Financial sustainability</b></p> <p>HIE faces significant financial risks and uncertainties in 2020/21 and the approved budget includes key assumptions in relation to these. HIE acknowledges that it will be challenging to manage these financial pressures alongside the uncertainty caused by Covid-19.</p> <p><b>Risk:</b> HIE is unable to deliver all of its financial commitments or meet performance targets within its existing resource allocation.</p>	<p>HIE should continue to keep its financial plans under close review during 2020/21 so that it is able to take early and informed decisions on options for dealing with the financial challenges it faces.</p>	<p>Continual review of budgets. Report financial risks and COVID-19 pressures to SG in monthly budget monitoring returns and to every Board meeting. Appropriate entries in Corporate Risk Register. Formal quarterly Finance &amp; Governance meetings with SG Sponsor Team and regular contact.</p> <p><b>Responsible officer:</b> Director of Finance &amp; Corporate Services</p> <p><b>Agreed date</b> Ongoing</p>



No.	Issue/risk	Recommendation	Agreed management action/timing
3	<p><b>Internal control arrangements</b></p> <p>The scale and pace of change as a result of Covid-19 poses a risk to HIE's governance arrangements.</p> <p><b>Risk:</b> there is a risk that key financial controls do not operate as intended due to new ways of working.</p>	<p>HIE should ensure that internal controls remain effective during this period of uncertainty and new ways of working.</p>	<p>The internal control arrangements will be reviewed at least quarterly and more regularly if there are further changes in the operating environment</p> <p><b>Responsible officer:</b></p> <p>Director of Business Improvement and Internal Audit</p> <p><b>Agreed date</b></p> <p>Ongoing</p>
4	<p><b>Performance report narrative</b></p> <p>The performance report narrative could be improved to ensure it is balanced and transparent.</p> <p><b>Risk:</b> there is a risk that HIE does not communicate its performance effectively to its stakeholders.</p>	<p>HIE should review the content and presentation of its performance report against Annex 5 of the FReM and Audit Scotland's good practice guide.</p>	<p>HIE is developing new systems to further address performance reporting, and proposed commissioning of measurement and evaluation work.</p> <p><b>Responsible Officer:</b></p> <p>Interim Director of Strategy and Regional Economy</p> <p><b>Agreed date</b></p> <p>Ongoing</p>

### Follow up of prior year recommendations

1	<p><b>Accounts preparation process.</b></p> <p>We identified a number of errors and omissions in how HIE reflected transactions within its financial statements.</p> <p><b>Risk:</b> the accounts do not give a true and fair view of HIE and its group's financial position and net expenditure.</p>	<p>Accounts preparation processes should be reviewed prior to the preparation of the 2019/20 annual report and accounts.</p>	<p><b>Ongoing</b></p> <p>Our audit identified fewer errors and no omissions this year. There is scope to further improve year end processes as set out in <a href="#">Exhibit 3</a>.</p> <p><b>Revised action</b></p> <p>We have noted a number of areas where we can improve our process. In particular our process around non-current assets are noted as not following best practice</p> <p><b>Responsible officer:</b></p> <p>Head of Financial Services</p> <p><b>Revised date</b></p> <p>30 June 2021</p>
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No.	Issue/risk	Recommendation	Agreed management action/timing
2	<p><b>Accounts preparation timetable</b></p> <p>The accounts presented for audit did not include the final revaluations of non-current assets or the tax computations.</p> <p><b>Risk:</b> the accounts do not give a true and fair view of HIE and its group's financial position and net expenditure.</p>	<p>HIE should ensure that the valuer's report and the taxation calculations are received in sufficient time to enable final figures to be included in the annual accounts presented for audit.</p>	<p><b>Completed</b></p> <p>The unaudited annual report and accounts included the final revaluations provided by the valuer and the tax computations.</p>
3	<p><b>Finance team capacity and expertise</b></p> <p>The nature of its business means that HIE needs to account for complex transactions. We have identified issues with the accounting of these complex transactions again this year. We also note that HIE outsources the preparation of some annual account areas.</p> <p><b>Risk:</b> HIE does not have sufficient financial capacity and skills to meet its needs.</p>	<p>HIE should consider whether its finance team has the capacity and expertise required to account for the range of complex transactions it is involved with and whether tasks currently outsourced to accountancy firms should be undertaken in-house.</p>	<p><b>Completed</b></p> <p>Following review of the finance team's capacity and skills, a graduate trainee and an experienced financial accountant have been appointed.</p>
4	<p><b>Financial sustainability</b></p> <p>HIE faces significant financial risks and uncertainties in 2019/20 and the agreed budget includes key assumptions in relation to these. Without additional support or authorisation from the Scottish Government it will be difficult to manage these financial risks and uncertainties without significant operational consequences.</p> <p><b>Risk:</b> HIE is unable to deliver all of its financial commitments or meet performance targets within its existing resource allocation.</p>	<p>HIE should continue to keep its financial plans under close review during 2019/20 so that it is able to take early and informed decisions on options for dealing with the financial challenges it faces.</p>	<p><b>Completed</b></p> <p>This risk has been superseded by action point 2 above.</p>



No.	Issue/risk	Recommendation	Agreed management action/timing
5	<p><b>Cyber security</b></p> <p>Cyber essentials have not yet been achieved.</p> <p><b>Risk:</b> key systems are not resilient enough to deal with a cyber-attack.</p>	<p>HIE should continue to work with its EIS partners to ensure cyber essentials is achieved. This will be further developed as the partnership moves towards cyber catalyst recognition.</p>	<p><b>Ongoing</b></p> <p>HIE does not yet have Cyber Essentials accreditation. This has been disclosed in the 2019/20 Governance statement.</p> <p><b>Revised action</b></p> <p>Detailed Cyber Essentials Plus action plan in place – led by EIS and overseen by Security Council</p> <p>Revised CE+ accreditation application currently planned for late October 2020</p> <p><b>Responsible officer:</b></p> <p>Director of Finance &amp; Corporate Services</p> <p>Revised date:</p> <p>31 October 2020</p>

# Appendix 2

## Significant audit risks identified during planning

The table below sets out the audit risks we identified during our planning of the audit and how we addressed each risk in arriving at our conclusion. The risks are categorised between those where there is a risk of material misstatement in the annual report and accounts and those relating to our wider responsibility under the [Code of Audit Practice 2016](#).

Audit Risk	Assurance procedure	Results and conclusions
<b>Risks of material misstatement in the financial statements</b>		
<p><b>1 Risk of material misstatement caused by management override of controls</b></p> <p>Auditing Standards require that audits are planned to consider the risk of material misstatement caused by fraud, which is presumed to be a significant risk in any audit. This includes the risk of management override of controls to change the position disclosed in the financial statements.</p>	<p>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>Results:</b></p> <p>Our audit work did not identify any issues that would indicate management override of controls affecting the year-end position.</p> <p>We considered the impact of Covid-19 on year-end valuations <a href="#">Refer Exhibit 3, point 1</a></p> <p>There were no significant transactions outside the normal course of business.</p> <p><b>Conclusion:</b> Satisfactory</p>
<p><b>2 Risk of material misstatement caused by fraud in income recognition</b></p> <p>As set out in ISA240, there is a presumed risk of fraud in the recognition of income. There is a risk that income may be misstated resulting in a material misstatement in the financial statements.</p> <p>HIE and its group received £16 million of income from sources other than the Scottish Government in 2018/19 and expects a similar amount in 2019/20. The extent, nature and complexity of this income means that there is an inherent risk of fraud.</p>	<p>Review of HIE's anti-fraud arrangements.</p> <p>Walk-through of controls over income/receivables.</p> <p>Analytical procedures on income streams.</p> <p>Detailed testing of revenue transactions focusing on the areas of greatest audit risk including property income and EU income.</p> <p>Substantive cut-off testing of income to ensure that it has been recognised in the correct financial year.</p>	<p><b>Results:</b></p> <p>Our review of HIE's anti-fraud arrangements did not identify any issues</p> <p>No issues were identified from our walkthrough of controls over accounts receivable, substantive testing of income transactions or cut-off testing.</p> <p><b>Conclusion:</b> Satisfactory</p>

Audit Risk	Assurance procedure	Results and conclusions
<p><b>3 Risk of material misstatement caused by fraud in expenditure</b></p> <p>As most public-sector bodies are net expenditure bodies, the risk of fraud is more likely to occur in expenditure. There is a risk that expenditure may be misstated resulting in a material misstatement in the financial statements.</p> <p>In 2018/19, HIE and its group recorded gross expenditure of £105 million. This includes a material level of grants to third parties. Given the extent, nature and complexity of expenditure, there is an inherent risk of fraud.</p>	<p>Review HIE's anti-fraud arrangements.</p> <p>Walk-through of controls over payables.</p> <p>Substantive testing of expenditure transactions with reliance on internal audit's work on significant transactions.</p> <p>Substantive cut-off testing of expenditure to ensure that it has been recognised in the correct financial year.</p> <p>Assessment of the results from HIE's participation in the National Fraud Initiative (NFI).</p>	<p><b>Results:</b></p> <p>Our review of HIE's anti-fraud arrangements did not identify any issues.</p> <p>No issues were identified from our walkthrough of controls over accounts payable, substantive testing of expenditure transactions or cut-off testing.</p> <p>All recommended NFI matches were reviewed and investigated. No frauds were found.</p> <p><b>Conclusion:</b> Satisfactory</p>
<p><b>4 Estimations and judgements</b></p> <p>ISA 540 is concerned with the auditor's responsibilities relating to accounting estimates and related disclosures in financial statements.</p> <p>There is a significant degree of subjectivity in the measurement and valuation of land and buildings (£34m), pension liabilities (£47m), and investments (£2m). There is also a degree of estimation and judgement in accrued expenditure (£6m), accrued income (£4m) and provisions (£14m).</p> <p>Estimates and judgements in these areas represent an increased risk of misstatement in the financial statements.</p>	<p>Review the work of an expert for the professional valuers (pensions liabilities and non-current assets).</p> <p>Review management's assessment of the appropriateness of the assumptions used in the valuation of these assets and liabilities.</p> <p>Review the progress of the ongoing VAT enquiry.</p> <p>Substantive testing of year-end balances including the accounting treatment for VAT related liabilities and the impact on the accounts.</p>	<p><b>Results:</b></p> <p>No issues were identified from our review of the work of the expert valuers.</p> <p>We reviewed progress made with the VAT enquiry. The accounts have been updated to reflect the most up to date position, and the correct accounting treatment for VAT liabilities.</p> <p>We considered the work undertaken by management and its expert valuers in light of the Covid-19 pandemic and considered the impact on the year-end valuations.</p> <p><a href="#">Refer to Exhibit 3, point 1.</a></p> <p><b>Conclusion:</b> Satisfactory</p>
<p><b>5 Finance team capacity and expertise</b></p> <p>The nature of its business means that HIE accounts for complex transactions. In previous years we identified issues with how HIE accounts for these transactions and recommended a review to ensure there is sufficient skills and capacity within the finance team.</p> <p>The ongoing VAT enquiry, and financial support and advice for Cairngorm Mountain and other complex projects continues to</p>	<p>Regular meetings with the Director of Finance and Corporate Services to identify any issues in respect of the finance team's capacity and the impact on the preparation of the financial statements.</p> <p>Review the progress of the ongoing VAT enquiry and the implications for HIE's accounts.</p> <p>We will also engage with officers during our 2019/20 audit to assess preparations</p>	<p><b>Results:</b></p> <p>Regular discussions were held with the Director of Finance and Corporate Services about progress made in recruiting an additional member of staff for the finance team. A qualified accountant with public sector experience took up post in April 2020.</p> <p>Following lockdown, regular discussions were held with the Director of Finance and Corporate Services to identify any issues</p>

Audit Risk	Assurance procedure	Results and conclusions
<p>put pressure on the finance team during 2019/20.</p> <p>Work is also required to assess the implications of IFRS 16 (Leases) and to ensure arrangements are in place to support its adoption in 2020/21.</p> <p>There is a risk that the finance team will not have the capacity or financial skills required to deliver the annual report and accounts to the agreed timetable and that complex transactions will not be accounted for</p>	<p>for the implementation of IFRS 16 (Leases) in 2020/21.</p>	<p>impacting on the preparation of the accounts.</p> <p>From end of May 2020, weekly meetings were held with the Director of Finance and Corporate Services and HIE's finance team to discuss matters arising from the audit.</p> <p>Progress with the VAT enquiry was monitored during the audit and the audited accounts updated to reflect the position agreed with HMRC in July 2020.</p> <p><a href="#">Refer to Exhibit 3, point 2</a></p>
<p>As noted in our Management Report, the introduction of IFRS 16 has been postponed to 1 April 2021 due to Covid-19.</p> <p><b>Conclusion:</b> Satisfactory</p>		

### Risks identified from the auditor's wider responsibility under the Code of Audit Practice

<p><b>6 Financial Sustainability</b></p> <p>HIE faces significant financial pressures in areas where there is uncertainty about the timing and amount of potential expenditure including costs associated with the Cairngorm funicular railway, the provision of working capital to Cairngorm Mountain (Scotland) Limited, the VAT enquiry and other major projects such as Spaceports.</p> <p>There is a risk that HIE is unable to deliver all of its financial commitments or achieve its performance targets within its existing resource allocations.</p>	<p>Review financial monitoring reports and the financial position at the year-end including performance against resource limits set by the Scottish Government.</p> <p>Ongoing discussions with HIE about its financial position.</p>	<p><b>Results:</b></p> <p>HIE underspent its resource allocations (RDEL and CDEL) in 2019/20.</p> <p>The 2020/21 budget contains a number of budgetary pressures and will be challenging to deliver.</p> <p><b>Conclusion:</b> given the financial pressures HIE faces in 2020/21, there is still a risk that it will be unable to deliver all of its financial commitments or achieve its performance targets within its existing resource allocations.</p>
<p><b>7 Governance and transparency - cyber security and business continuity planning</b></p> <p>Organisations are increasingly threatened by cyber-attacks. In August 2019, internal audit reviewed arrangements within EIS (HIE's shared IT arrangement with Skills Development Scotland (SDS) and Scottish Enterprise (SE) and reported that there were key areas for improvement.</p>	<p>Review progress in addressing the recommendations raised by internal audit and co-ordinate our work with the external auditors of SDS and SE.</p> <p>Place reliance on any internal audit follow-up work.</p> <p>Review progress made in developing business continuity plans for all HIE's key locations.</p>	<p><b>Results:</b></p> <p>Although internal audit noted that EIS made good progress in addressing its recommendations, the remaining recommendations are expected to be addressed once EIS has undertaken a Cyber Maturity Assessment.</p> <p>Refer to paragraphs 93 to 95.</p> <p>HIE tested its business continuity plan prior to lockdown and all staff were able to move seamlessly to home working.</p>

Audit Risk	Assurance procedure	Results and conclusions
<p>In addition, HIE has yet to prepare business continuity plans for all its key locations.</p> <p>There is a risk that a cyber-attack or some other type of business interruption could disrupt HIE's systems, including its key financial systems.</p>		<p>Refer to paragraphs 82 to 84.</p> <p><b>Conclusion:</b> EIS has made good progress but there is still a risk that a cyber-attack could disrupt HIE's systems.</p>
<p><b>8 Value for money</b></p> <p>HIE has developed a new Strategic Plan covering the period 2019-2022 to reflect significant changes in its internal and external operating environments.</p> <p>There is a risk that the new performance management arrangements are not aligned with the Enterprise and Skills Strategic Board's missions and that, as a result, HIE is unable to demonstrate progress and its contribution to the Scottish Government's National Performance Framework.</p>	<p>Review HIE's Strategic Plan's alignment with the Enterprise and Skills Strategic Board's missions.</p> <p>Consider the impact of the Strategic Board's strategic plan on HIE's performance management arrangements, in particular whether appropriate measures are in place to report on achievement of its objectives.</p>	<p><b>Results:</b></p> <p>HIE's performance management arrangements have been aligned with the Enterprise and Skills Strategic Board, and these are reported regularly to the HIE Board.</p> <p>Refer to paragraphs 98 to 103.</p> <p><b>Conclusion:</b> Satisfactory</p>

# Appendix 3

## Summary of national performance reports 2019/20

		 <b>2019/20 Reports</b>	
		Apr	
Social security: Implementing the devolved powers		<b>May</b>	
Scotland's colleges 2019		<b>Jun</b>	 Enabling digital government
		Jul	
NHS workforce planning - part 2		<b>Aug</b>	
Finances of Scottish universities		<b>Sept</b>	
NHS in Scotland 2019		<b>Oct</b>	
		Nov	
Local government in Scotland: Financial overview 2018/19		<b>Dec</b>	
Scotland's City Region and Growth Deals		<b>Jan</b>	 Privately financed infrastructure investment: The Non-Profit Distributing (NPD) and hub models
		Feb	
		<b>Mar</b>	 Early learning and childcare: follow-up

### Central Government relevant reports

[\*Social security: Implementing the devolved powers\*](#) – May 2019

[\*Enabling digital government\*](#) – June 2019

[\*Scotland's City Region and Growth Deals\*](#) – October 2019

[\*Privately financed infrastructure investment: The Non-Profit Distributing \(NPD\) and hub models\*](#) – Jan 2020

[\*Early learning and childcare: follow-up\*](#) – March 2020

# Highlands and Islands Enterprise

## 2019/20 Annual Audit Report

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